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TAX INFORMATION

Bulletin

Inland Revenue
Te Tari Taake

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SEE INSIDE BACK COVER FOR TIB READER SURVEY

Next year TIB will celebrate 20 years of bringing you information about changes to tax-related legislation, proposed legislation, judgments, rulings and other specialist tax topics. We thought it timely to get your feedback on the bulletin's contents and presentation and to know if there are other areas of information TIB could usefully bring you. We invite you to complete the TIB reader survey included on the inside of the back cover of this issue to help us ensure that TIB continues to meet the needs of its readers.

REGULAR CONTRIBUTORS TO THE TIB

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

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

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

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

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

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

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

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

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

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

Ref	Draft type	Description/background information	Comment deadline
INS0072	Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994.	This item sets out the Commissioner's view of his responsibility for the "care and management of the taxes covered by the Inland Revenue Acts" in section 6A(2) of the Tax Administration Act 1994. In the course of doing so, the item clarifies the relationship between the care and management responsibility and the Commissioner's obligations under section 6(1) and section 6A(3) of the Tax Administration Act 1994. The conclusions reached are illustrated by considering specific factual examples.	31 October 2008
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This legislation introduced new tax rules for limited partnerships, such as rules to allocate income and deductions to partners. It also updated and clarified the existing income tax rules relating to general partnerships.

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A new double tax agreement (DTA) between New Zealand and the Czech Republic has entered into force, as has a protocol amending the existing DTA with the United Kingdom. A new tax information exchange agreement with the Netherlands on behalf of the Netherlands Antilles has been incorporated into New Zealand law and Mexico and Austria have been added to the list of treaty partners approved for the purpose of the "venture capital exemption". Arrangements for assistance in collection of taxes under the DTA with Australia became effective on 8 September 2008.

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Associated persons test
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NEW LEGISLATION

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

TAXATION (LIMITED PARTNERSHIPS) ACT 2008

Sections CB 27B, CB 35, CU 3 to CU 10, CU 11(2), CU 17, CU 19(6)(c), CW 55B, CX 62, DV 20, DO 11B, DU 1 to DU 7, DU 8(2), EW 58(2), EX 13, EZ 37(10), GB 29(2)(b), GB 50, HD 20, HD 20B, subpart HG, HR 1, HZ 3, HZ 4, RE 30, YA 1, YB 16(1B), YB 17(1B), YD 4(17B) of the Income Tax Act 2007; sections 22(4)(c) and 42 of the Tax Administration Act 1994; section 2(1) of the Goods and Services Tax Act 1985

Recently enacted legislation introduced new tax rules for limited partnerships and updated and clarified the existing income tax rules relating to general partnerships.

The changes were part of the Limited Partnerships Bill, introduced in August 2007, which also introduced new regulatory rules for limited partnerships that were intended to make it easier for New Zealand firms to have access to investment capital. That was achieved through the introduction of a new limited partnership vehicle that allows partners to participate in a partnership while limiting their liability in particular circumstances.

The resulting Limited Partnerships Act 2008 and Taxation (Limited Partnerships) Act 2008 received Royal assent on 13 March 2008. The latter amended the Income Tax Act 2007, the Tax Administration Act 1994 and the Goods and Services Tax Act 1985.

This article describes the resulting tax changes. Unless otherwise stated, section references are to the Income Tax Act 2007, where the main changes occurred.

Background

The primary objective of the new limited partnerships rules is to facilitate sustainable growth in New Zealand's investment capital sectors such as venture capital. Given that New Zealand's investment capital sectors are relatively small and remote by world standards, it was particularly important for New Zealand to adopt a limited partnership structure that was consistent with international norms and provided a legal and tax structure that is recognised and accepted by investors.

New Zealand previously had a statutory form of limited partnership called the "special partnership", as described in Part 2 of the Partnership Act 1908. However, because the legislation was outdated, it did not have all the features preferred by foreign venture capital investors, and the local venture capital industry had been unable to make use of the existing special partnership rules. These rules have now been replaced by the Limited Partnerships Act 2008.

The associated tax changes are contained in the Taxation (Limited Partnerships) Act 2008.

Key features

- A new definition of "partnership" clarifies which partnership arrangements are covered by the new rules.
- Income, expenses, tax credits, rebates, gains and losses are allowed to flow through to individual partners. These items will generally be allocated to the partners in proportion to each partner's share in the partnership's income. Partners are also able to deduct partnership expenditure incurred by the partnership before they became a member, subject to the other deductibility tests in the Act.
- Transactions between partners within partnerships that are not at market value and that undermine the partnership income tax rules need to be at market value for tax purposes, a requirement designed to protect the tax base.
- Partners are required to account for tax on exiting the partnership only if the amount of the disposal proceeds derived from the partnership interest exceeds the total net tax book value of their share of partnership property by more than $50,000. However, if this threshold is exceeded, exiting partners will not have to account for tax on things such as trading stock in certain circumstances. When exiting partners account for tax on their share, incoming partners and the partnership must take on a cost basis in the partnership's assets and liabilities that is equal to the deemed disposal under the disposal provisions. When exiting partners account for tax on livestock, incoming partners may deduct the value of the adjustment on a straight-line basis over five years. Partners in a partnership of five or fewer partners may elect to be treated as owning an undivided interest in the property and income of the partnership instead of following the partnership interest disposal rules.
- The new rules clarify when dissolution of a partnership occurs for tax purposes and the tax consequences of dissolution.

- Tax loss limitation rules for limited partners ensure that the losses claimed reflect the level of their economic loss. Limited partners' excess tax losses are also available for carry-forward to future income years. Furthermore, an anti-avoidance rule has been introduced to prevent artificially high basis around the year-end being used to increase any loss flow-through.
- General partners of a limited partnership are treated as an agent of an absentee limited partner.
- A simple transition from a special partnership to a limited partnership will not generally result in the triggering of income tax provisions to the partners. Special partnerships that still exist are not required to comply with the loss limitation rules.
- Two options are available for the calculation of a limited partner's opening basis amount for existing partnership interests.
- The rules also clarify how the income tax source rules apply to partnership income.
- The record-keeping and filing obligations of partnerships have been clarified.

Application date

For general partnerships, the amendments apply to income years beginning on or after 1 April 2008. For limited partnerships, the new rules apply to limited partners from 1 April 2008.

Detailed analysis

Definition of partnership

A new definition of "partnership" in section YA 1 of the Income Tax Act 2007 specifies the partnership arrangements that are covered by the new rules. The Act previously contained no general definition of "partnership". Under the new definition a partnership is a group of two or more persons who have, between themselves, the relationship described in section 4(1) of the Partnership Act 1908. The Income Tax Act 2007 definition of "partnership" includes a joint venture and co-owners of property if the joint venturers or co-owners all choose to be treated as a partnership for income tax purposes. A limited partnership is also included in the new partnership definition.

Limited partnerships

A new definition of "limited partnership" has been inserted into section YA 1 of the Income Tax Act 2007. A limited partnership is one that is registered under the Limited Partnership Act 2008. It must have at least one general partner and one limited partner. A general partner is responsible for the management of the partnership, while a limited partner is not responsible for management.

"Limited partnership" includes an "overseas limited partnership", as defined in section 4 of the Limited Partnership Act 2008. Under that definition, it is a partnership formed or incorporated outside New Zealand that has at least one general partner who is liable for the debts and liabilities of the partnership and at least one limited partner who is not. Such a partnership does not have separate legal entity status.

The new definition of limited partnership excludes a "listed limited partnership", which is an entity or group of persons that is listed on a recognised exchange and is either a limited partnership registered under the Limited Partnership Act 2008 or an overseas limited partnership.

The limited partnership definition also excludes a "foreign corporate limited partnership", which is an overseas limited partnership that is treated as a separate legal entity under the laws (other than taxation laws) in the jurisdiction where it was established.

The liability of general and limited partners is set out in Part 2 of the Limited Partnership Act 2008. The liability of limited partners is limited by the extent to which they contribute to the management of the partnership. Limited partners' activities are limited to "safe harbour activities" and must not extend to the day-to-day management of the partnership.

A limited partnership is a separate legal entity under the Limited Partnerships Act 2008. However, under the Income Tax Act 2007 a limited partnership is not treated as a "company" and instead is treated as a partnership. As a result, income and expenses will flow through the limited partnership to the partners. Therefore the limited partnership itself will not be taxed; instead, partners will be taxed individually.

Transparency of partnerships

Section HG 2 codifies the principle that partnerships are transparent for income tax purposes. For the purposes of calculating partners' obligations and liabilities, they are treated as carrying on activities and having the status, intention and purpose of the partnership. Partnerships are treated as not carrying on these activities or having such an intention or purpose. This does not necessarily mean that the activities, status or intention of a partnership are attributed to partners in relation to their non-partnership activities. For example, a partner of a land-dealing partnership is not treated as having the status or intention of the partnership in relation to land that he or she owns in a capacity other than that of a partner.

Partners are also treated as holding property in proportion

to their partnership share, being parties to an arrangement, and doing or being entitled to a thing, through their capacity as partner. Partners will be treated as doing, having, or being party to these things, and partnerships will not. In the absence of a partnership agreement, these items will be apportioned to partners under the Partnership Act 1908 or whichever law determines their right to a share in the partnership income.

There are limited situations, however, where partnerships are not treated as being transparent for tax purposes. This is recognised in section HG 2(1), which outlines the principle that partnerships are transparent "…unless the context requires otherwise". An example of a situation where it is clear from the statutory context that a partnership should not be viewed as transparent is in relation to resident withholding tax (RWT) exemption certificates. Section RE 30 of the Income Tax Act 2007 and section 32J of the Tax Administration Act 1994 provide that it is the partnership rather than the partners that holds an RWT exemption certificate.

Amendments have been made to income and deduction provisions, and in particular to sections CB 35, CW 55B, CX 62 and DV 20, that reflect the changes made by section HG 2.

Flow-through of income, expenses and other items

Section HG 2(2) provides that income, tax credits, rebates, gains, expenditure or loss of the partnership will be allocated in proportion to each partner's share in the partnership's income or, in the absence of a partnership agreement, in accordance with the relevant law.

The proportionate approach prevents streaming of these items to specific partners, by requiring them to be allocated to the partners in the same proportion as their respective shares in the partnership's income. It also provides certainty in the allocation of these items for income tax purposes, and ensures that they cannot be streamed to take advantage of the different tax circumstances of the partners.

The proportionate approach does not, however, prevent a partner from having different proportions of shares in different types of partnership property. This is clear from the definition of "partnership share" in section YA 1, which defines "partnership share" as the partner's share in each different type of partnership property. This allows, for example, a partner's share in the income to be different from the partner's share in the assets for income tax purposes.

Under section HG 2(3) expenditure apportioned to new partners who were not partners when the expenditure was originally incurred will generally be deductible, subject to the other tests of deductibility in the Income Tax Act. This marks a departure from the previous law as new partners were previously not entitled to claim expenditure incurred through the original partnership because they did not generally meet the "incurred test". The deduction will be allocated to either the exiting or the incoming partner. It will not be available to both.

Transactions between partners and partnerships

New section GB 50 provides that transactions between partners under an arrangement will be treated as being at market value for income tax purposes if a purpose or effect of the arrangement is to defeat the intent and application of the new partnership rules in subpart HG. This is designed to protect the tax base.

Transactions that do not occur at market value, such as goods provided at a discount, are likely to have an impact on limited partners' partnership basis, with excess value given to a partnership being treated as a capital contribution, and excess value received from a partnership being treated as a distribution.

Entry and exit of partners and changes to partnership interest

General

Under the transparent approach for partnerships provided in section HG 2, partners are treated as holding the partnership property directly, carrying on the activities of the partnership and having the status and intention of the partnership. Therefore when partners exit the partnership by disposing of their partnership interest they would, without specific provision otherwise, be treated as disposing of their share of the underlying partnership property and bearing any tax consequences associated with the disposal. This could result in significant compliance costs for partners and partnerships.

Therefore sections HG 5 to HG 9 remove the requirement for the exiting partner to account for tax when the tax adjustment that would otherwise be required is below certain thresholds. When these provisions apply, the new partner (the "entering partner") is treated as acquiring the partnership interests for the same cost that the exiting partner had acquired them. In other words, the entering partner receives the same cost basis as the exiting partner – thereby ensuring that the tax consequences associated with the exit are delayed rather than extinguished. In these situations, therefore, the entering partner can effectively bear the tax obligations of the exiting partner and may adjust the purchase price of the partnership interest accordingly.

Partners in "small partnerships" (defined in section YA 1 as those partnerships with five or fewer partners that are

not limited partnerships) can elect out of sections HG 5 to HG 9 by furnishing a return of income that ignores these sections. In this situation the partners will be treated as owning an undivided interest in the property and income of the partnership.

$50,000 threshold – section HG 5

Under section HG 5 a partner is required to account for tax on exiting the partnership only if the amount of the disposal proceeds derived from the partnership interest exceeds the total net tax book value of the partner's share of the partnership property (less any liabilities under generally accepted accounting practice) by more than $50,000. When interests in the same partnership have been sold within a 12-month period, all sales are taken into account for the purposes of the threshold. The following simple example illustrates the operation of section HG 5.

In May 2009 Paul and John establish a two-person partnership. The business of the partnership is to buy shares in New Zealand-resident listed companies with the purpose and intention of making a profit on resale. They each contribute $50,000 to the partnership and, therefore, each have a partnership share of 50 percent. The partnership uses the $100,000 to purchase 10,000 shares in A Co for $10 per share. The partnership and the partners have a standard balance date.

In March 2010 the market value of the partnership's shares in A Co has risen to $150,000 ($15 per share). In the same month John sells his entire 50 percent partnership interest to Janet for $67,500. (Even though the shares have a market value of $75,000 Janet negotiates a discounted purchase price to compensate for additional tax liabilities that she may face.).

Application of new tax rules for the 2009–10 income year

Section HG 2(1)(a) treats John as carrying on the share trading business of the partnership. Section HG 2(1)(b) treats him as holding 50 percent of the A Co shares directly. Section HG 2(1)(d) treats him as doing a thing that the partnership does. John is therefore treated as purchasing 50 percent of the underlying shares in A Co and disposing of these shares when he sells his entire partnership interest to Janet in March 2010. Therefore, without section HG 5, the profit of $17,500 ($67,500 minus $50,000) would be taxable to John.

The partners and the partnership decide not to elect out of section HG 5. Section HG 5 applies in this case as the taxable profit for which John would otherwise be liable is less than $50,000. (That is, under section HG 5(1) the "disposal payment" ($67,500) plus any "previous payments" ($0) minus the "gross tax value" ($50,000) minus "liabilities' ($0) minus $50,000 is less than zero.) This means that John is not taxable on the $67,500 disposal payment (section HG 5(3)) and does not have a deduction for the $50,000 spent on the shares in A Co (section HG 5(4)).

Section HG 5(6) treats Janet (the entering partner) as having acquired the original partnership interests. In other words, for the purposes of calculating future tax liabilities, Janet's cost basis for the shares in A Co is $50,000.

Sections HG 6 – HG 9

Even if the $50,000 threshold in section HG 5 is exceeded, however, an exiting partner does not have to account for tax, in certain circumstances, on:

- *Trading stock – section HG 6*

  Exiting partners do not have to perform a revenue account adjustment for trading stock if the total annual turnover of the partnership is $3 million or less.

- *Depreciable tangible property – section HG 7*

  Exiting partners do not have to account for depreciation recovery or loss on their share of any depreciable tangible asset of the partnership if the historical cost of the asset is $200,000 or less.

- *Financial arrangements – section HG 8*

  Exiting partners are not required to perform a base price adjustment for their interest in a financial arrangement if:

  – the partnership is not itself in the business of deriving income from financial arrangements; and
  – the financial arrangement has been entered into as a necessary and incidental purpose of the business.

  For example, exiting partners are not generally required to perform a base price adjustment in respect of their interest in a loan that provides capital for a partnership's business.

- *Certain financial arrangements and excepted financial arrangements – section HG 8*

  Exiting partners do not have to account for tax on financial arrangements and excepted financial arrangements described in section EW 5(10). These are interest-free loans made in New Zealand currency that are repayable on demand.

- *Short-term sale and purchase agreements – section HG 9*

  Section HG 9 applies when exiting partners dispose of some or all of their partnership interests in a short-term sale and purchase agreement. The consideration that the exiting partner receives is excluded income. In addition, both the entering and exiting partners are denied any deduction for this. In the exiting partner's case, this is because for income tax liability purposes the entering partner is treated as having originally acquired the property or services contained in the agreement.

Livestock – sections HG 10, CB 27B, DO 11B

Section HG 10 applies when a partner exits the partnership and the partnership property consists of livestock that is not valued using the herd scheme or one of the cost price, replacement price or market value methods described in

section EC 25. In these circumstances the entering partner is treated as if they had originally purchased and held the livestock – not the exiting partner. This is designed to reduce compliance costs for partnerships as the partnership will not be required to maintain different cost bases for different partners.

If the exiting partner has accounted for tax on the livestock, the entering partner can choose to deduct the amount of that adjustment on a straight-line basis over a five-year period under section DO 11B. Similarly, if an exiting partner has a loss on disposal for livestock, the incoming partner must account for income on a straight-line basis over a five-year period under section CB 27B.

However, the partnership and the partners can opt out of the five-year spreading method under section HG 10(3) by furnishing a joint return of income that ignores the section.

When an exiting partner accounts for tax on exit

When exiting partners account for tax in respect of their share of the partnership assets and liabilities, the partnership and the incoming partner must take on a cost base in the partnership's assets and liabilities. The cost base must be equal to the amount the exiting partner was deemed to have disposed of them for under the disposal provisions.

In these situations incoming partners will generally acquire their partnership interest at market value. This means that, generally, they will take on a market value cost base in partnership assets and liabilities. An exception is livestock, which is discussed above.

Introduction of a new partner

The introduction of a new partner into a partnership does not trigger a tax event for the existing partners. This is because the addition of a new partner would not result in a "disposal" of partnership property for an existing partner under section YA 1.

Dissolution of a partnership

The new tax rules clarify when the dissolution of a partnership will occur for tax purposes, and the tax consequences of dissolution. Previously, the legislation was silent as to the tax consequences of partnership dissolution. New section HG 4 deems the partnership to have disposed of all its assets at market value for tax purposes on dissolution. A partnership is not automatically treated as dissolving for tax purposes when there is a change in partners or a smaller change in partnership interests, but there is a deemed sale and reacquisition by all partners at market value when the partnership finally dissolves through the agreement of partners, or through operation of law by which fewer than two parties remain, or by an order of the court.

The Minister of Revenue has announced a proposal that would provide an exception to the general rule that triggers a tax event for partners upon dissolution of a partnership. According to the announcement, the exception would apply to dissolutions of two-person partnerships where the partners are married, or in a relationship in the nature of marriage, and the dissolution is caused by the death of one of the partners. When this occurs the surviving spouse will often inherit the deceased spouse's partnership share under the deceased spouse's will. Under the current law any tax consequences associated with the inherited share are delayed until the surviving spouse sells the assets. In these circumstances it is proposed to delay the triggering of a tax event in respect of the surviving spouse's original partnership share until the assets are actually sold. This measure is designed to reduce compliance costs for surviving spouses. The announcement states that the measure will apply from the start of the 2008–09 income year.

Limitation of limited partner's tax losses

New section HG 11 ensures that limited partners' tax losses are restricted if the amount of the loss exceeds the tax book value of their investment (the partner's basis). This is to ensure that limited partners can offset tax losses only to the extent they reflect their economic losses. This provision applies only to limited partners because general partners have unlimited liability and therefore full exposure to the risk of loss.

Basis calculation

A limited partner's adjusted investment in a partnership is referred to as the "partner's basis". In calculating their basis, limited partners will take into account the sum of their:

- investment contributions
- share of the partnership debt guaranteed (or indemnities provided) by the partner
- share of the net limited partnership income previously recognised
- share of the capital gains previously realised
- any previous equity injections

Less their:

- share of the partnership debt guarantees (or indemnities) retired or extinguished by the partner
- share of the net limited partnership loss previously deducted
- share of the capital losses previously realised
- any previous distributions.

If their basis is reduced to nil and they are denied a deduction for a tax loss for an income year under section HG 11, the deduction is carried forward to the next income year under section HG 12. The deduction becomes available when additional basis becomes available, such as when a partner contributes more capital to the partnership (putting more capital at risk) or the partnership earns income.

The following simple example explains how these rules work.

On 1 April 2009 Limited Partnership X is established. Limited Partnership X has two partners – Eve and Sam – who each make an investment of $10,000. They share equally in the net income and loss of the partnership.

Partnership X borrows $1 million from the bank at an annual interest rate of 10%. The annual interest cost of $100,000 is deductible under the Income Tax Act 2007. On 1 June 2009 the partners each receive a distribution from the partnership of $5,000. The partnership derives $20,000 of gross income for the 2009–10 income year.

Application of tax rules to Eve for the 2009–10 income year

Eve has a partnership share in the income of Limited Partnership X of 50 percent. Therefore, under section HG 2(2), she has gross income of $10,000 (50% of $20,000) and an allowable deduction of $50,000 (50% of $100,000) from the partnership.

However, section HG 11(2) denies her a deduction to the extent that the amount exceeds her basis in the partnership. For the 2009-10 income year she has basis in the partnership of $15,000 – calculated under section HG 11(3) as follows:

• Investments	$10,000
	Minus
• Distributions	$5,000
	Plus
• Income	$10,00
	Minus
• Deductions taken in previous years	$0
	Minus
• Disallowed amounts	$0

This means that the deduction she is allowed for the 2009-10 income year from her investment in Limited Partnership X is $15,000. Under section HG 12(2) she carries forward the $35,000 deduction she is denied to the next income year. She will need to apply section HG 11 again in the next income year to determine how much of the deduction is allowed in that year.

Anti-avoidance rule

To prevent the artificial creation of a high basis around the end of the year when loss flow-through is taken into account, a limited partner's basis is reduced by the amount the basis is increased if:

- the limited partner's basis is increased within 60 days before the end of the income year, and
- the limited partner's basis is subsequently reduced within 60 days after the end of the income year.

General partner liable if limited partner an absentee

New section HD 20B ensures that the general partner of a limited partnership is treated as an agent of an absentee limited partner for income derived from a partnership business carried on in New Zealand. It is anticipated that limited partnerships will be widely held and similar to a company; therefore it would be impractical to impose this liability on all the partners. General partners in a limited partnership are usually responsible for management of the limited partnership and are also liable for the debts and obligations of the partnership. General partners are therefore treated as agents of an absentee limited partner for income derived from a partnership business carried on in New Zealand.

Transitional issues

Part 2 of the Partnership Act 1908, which relates to special partnerships, has been replaced by the Limited Partnerships Act 2008. Under section HZ 3 of the Income Tax Act 2007 special partnerships will continue to exist until their expiry. Partners of special partnerships are not required to comply with the loss limitation rules for this remaining period.

Under the previous rules, the cessation of a special partnership and the creation of a limited partnership would generally have crystallised a tax event. However, under the new rules, a simple transition from a special partnership to a limited partnership will not generally have income tax consequences for the partners if the business and ownership of the partnership remains the same.

New Zealand-resident partners of special partnerships that make the transition into the new limited partnership rules can determine their initial basis by either:

- the market value of their interest in the limited partnership, or
- calculating their basis as if the rules were in effect the entire time the partner has held the partnership interest.

Associated persons rules

Section YB 16 treats a partnership and a partner in the partnership as associated persons. The section has been amended to provide an exception in the case of a limited partner. Limited partners and their respective limited partnership will be associated persons only if the limited partners have a partnership share of 25 percent or more in the limited partnership.

Section YB 17 also treats a partnership and a person associated with a partner as associated persons. The section has been similarly amended so that a limited partnership and a person associated with a limited partner will be associated persons only if the limited partner has a partnership share of 25 percent or more.

Source rules

Section YD 4 has been amended to provide that income is treated as being sourced in New Zealand if, treating all the partners of a New Zealand partnership as resident in New Zealand, the income is sourced in New Zealand under a provision in that section. A "New Zealand partnership" is defined in section YA 1 as a partnership that is a limited partnership registered under the Limited Partnerships Act 2008, or has 50 percent or more of its capital held by New Zealand residents, or has its centre of management in New Zealand.

Repealed provisions

A number of provisions that provided that partnerships were transparent for specific income tax purposes have been repealed because the general transparent approach in new section HG 2 made them redundant. The repealed provisions are sections CU 11(2), CU 19(6)(c), DU 8(2), EW 58(2), EX 13 and EZ 37(10). Section HR 1, which related to partnerships and joint ventures, has been repealed as a consequence of the enactment of the new partnership rules in subpart HG. The parts of former section HR 1 that related to persons other than partners who derive income jointly or have deductions jointly have been relocated to new section HG 1.

Record-keeping and filing requirements

Section 22 of the Tax Administration Act 1994 has been amended to clarify that it is the partnership, rather than each partner in the partnership, that must maintain records, in accordance with the usual practice.

Tax legislation often refers to a "person's" obligation to fulfil record-keeping requirements. A partnership is a "person" within the meaning of the Interpretation Act 1999 (being an unincorporated body of persons), as is a partner. It can be inferred from this that all partners, as well as the partnership, must maintain separate (yet identical) records. In practice, the partnership typically keeps one set of records relating to all the partners and all the firm's activities. The new legislation brings the law into alignment with current practice.

Section 42 of the Tax Administration Act 1994 has been amended to clarify the return filing obligations of partnerships and partners.

Goods and Services Act 1985

The interpretation section of the Goods and Services Act 1985 has been amended to clarify that a limited partnership will be treated as a company for GST purposes.

OTHER POLICY MATTERS

NEW DOUBLE TAX AGREEMENT WITH THE CZECH REPUBLIC, NEW PROTOCOL TO THE UNITED KINGDOM AGREEMENT, AND OTHER TAX TREATY DEVELOPMENTS

A new double tax agreement (DTA) between New Zealand and the Czech Republic has entered into force, bringing New Zealand's total number of DTAs in force to 35. A protocol amending the existing DTA with the United Kingdom has also entered into force. Orders in Council have been made to incorporate into New Zealand law a new tax information exchange agreement with the Netherlands on behalf of the Netherlands Antilles and to add Mexico and Austria to the list of treaty partners approved for the purpose of the "venture capital exemption" in section CW 12 of the Income Tax Act 2007. In addition, arrangements for assistance in collection of taxes under the DTA with Australia became effective on 8 September 2008.

New double tax agreement with the Czech Republic

The new DTA with the Czech Republic is expected to play an important part in facilitating increased bilateral trade and investment. DTAs are designed to provide certainty of tax treatment and to prevent the double taxation of cross-border transactions. By providing for the exchange of information on tax matters, DTAs also play a valuable role in preventing tax avoidance and evasion.

The DTA was signed on 26 October 2007 and incorporated into New Zealand law by Order in Council on 28 July 2008. DTAs do not enter into force until the necessary legal procedures have been completed in both countries. Those procedures have now been completed in both countries, and the agreement entered into force on 2 September 2008. The agreement has effect for New Zealand withholding taxes from 1 January 2009 and for other New Zealand taxes for income years beginning on or after 1 April 2009.

Protocol amending the existing double tax agreement with the United Kingdom

The protocol with the United Kingdom updates Article 25 "Exchange of information" of the DTA to allow for information exchanges in relation to taxes other than income tax. The protocol also inserts a new article "Assistance in the collection of taxes" into the DTA, to allow the tax authorities of the two countries to request assistance from each other in the collection of tax debt.

The protocol was signed on 7 November 2007. An Order in Council incorporating the protocol into New Zealand law was made on 28 July 2008. The protocol entered into force on 28 August 2008, and its provisions have effect from that date.

New tax information exchange agreement with the Netherlands on behalf of the Netherlands Antilles

The tax information exchange agreement with the Netherlands will enable the tax authorities of New Zealand and the Netherlands Antilles to exchange information on tax matters in order to assist each other in the detection and prevention of tax avoidance and evasion.

The agreement was signed on 1 March 2007 and incorporated into New Zealand law by Order in Council on 1 September 2008. The agreement will enter into force once both countries have completed an exchange of diplomatic notes confirming that all domestic processes for entry into force are complete. This is likely to be complete by the time of publication.

Austria and Mexico added to the list of approved countries

An Order in Council was made on 1 September 2008 adding Mexico and Austria to the list of approved treaty partners for the purposes of the "venture capital exemption" in section CW 12 of the Income Tax Act 2007. The Order in Council will enter into force on 2 October 2008. From that date, qualifying investors from Austria and Mexico will not be subject to New Zealand tax on gains on the value of shares in certain listed New Zealand companies.

Assistance in collection under the double tax agreement with Australia

Now it has taken effect, Article 27 "Assistance in collection of taxes" in the DTA with Australia will facilitate cooperation between Australia and New Zealand in the recovery of outstanding tax debt.

A protocol making changes to New Zealand's existing DTA with Australia was signed on 15 November 2005. An Order

in Council incorporating the protocol into New Zealand law was made on 26 June 2006. The protocol came into force on 22 January 2007 and has effect from that date, except for Article 4, which inserts new Article 27 "Assistance in collection of taxes". The date from which the new assistance in collection article takes effect has now been agreed by the governments of Australia and New Zealand as 8 September 2008.

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.

EXPENSE ITEMS IN THE TABLE OF DEPRECIATION RATES

The Commissioner's Table of Depreciation Rates ('the table') lists general economic depreciation rates and provisional depreciation rates set by the Commissioner. The table, set out in industry and asset categories, is compiled from Tax Depreciation Determinations issued by the Commissioner.

Several of these determinations include items of property where the Commissioner has not set an estimated useful life and has included the word "expense" in the diminishing value rate and the straight line rate columns. For example in "Determination DEP1: Tax Depreciation Rates General Determination Number 1", in the "Contractors, builders and quarrying" industry category, items such as "Abrasive cutting wheels", "Drilling bits (except as shown) and similar tooling", "Drop sheets", and "Grinding wheels" are listed as "expense".

These items were included in the determinations for completeness. However, there is no legislative basis for non-capital items to be included in determinations. Consequently, to ensure that the table is correct in terms of the legislation, these items are being removed from the table as indicated below. The Commissioner stresses that correcting the table by removing these expense items does not affect the income tax treatment of their cost. They will continue to be fully deductible, subject to the usual deductibility tests that require a sufficient connection with an income earning activity or business.

The items are being removed from the table for one (or more) of the following reasons as noted in the attached table:

1. they are consumables and fully deductible for income tax purposes(c), or
2. the replacement of these items, when they are part of a larger item, would qualify as repairs and maintenance (r), or
3. the items are no longer in general use in the respective industries (n).

Note that if the "replacement" items in number 2 are first purchased as part of a larger capital asset, their cost will generally be included in the cost of the larger item and depreciated at the rate set for that larger item. In such cases the item is only expensed when it is later replaced.

There may possibly be some items of property that are currently shown as "expense" that taxpayers may consider are depreciable property for which an economic depreciation rate should be set. Details on how to apply to the Commissioner for a provisional depreciation rate are available on Inland Revenue's website -www.ird.govt.nz

TABLE:

"Expense items" being removed from the table that are included in the following tax depreciation rates determinations.

Items will still be fully deductible for income tax purposes as "consumables" under general accounting principles.

Tax depreciation rates determination	Item(s) listed as "expense"	Industry/asset category in Table of Depreciation Rates	Reason for removal
Determination DEP1:Tax Depreciation Rates General Determination Number 1	Abrasive cutting wheels	Contractors, builders and quarrying	c or r
	Aprons (protective)	Clothing	c
	Binders	Office equipment and furniture	c
	Boots	Clothing	c
	Bottles (returnable)	Brewing, winemaking and distilleries	c or n
	Brooms	Cleaning, refuse and recycling	c
	Brushes	Cleaning, refuse and recycling	c
	Coolant charge	Refrigeration	c
	Disks	Computers	c or n *
	Drilling bits except diamond drill bits and saw blades	Concrete and plaster	c or r
	Drilling bits and similar tooling except diamond drill bits and saw blades	Contractors, builders and quarrying	c or r
	Drill bits	Mining	c or r
	Drills, taps, milling cutters, grinding wheels and similar tooling except diamond drills and saws	Engineering (including automotive)	c or r
	Drop sheets	Contractors, builders and quarrying	c
	Folders and the like	Office equipment and furniture	c
	Fourdrinier wires	Pulp and paper Manufacturing	c
	Grinding and abrasive cutting wheels	Metal industries (primary) and foundries	c or r
	Grinding wheels	Contractors, builders and quarrying	c or r
	Gumboots	Clothing	c
	Kiln furniture	Pottery, tile and brick making	c
	Knives, steels and the like	Meat and fish processing	c
	Machine blankets	Pulp and paper manufacturing	c
	Mops	Cleaning, refuse and recycling.	c
	Moulds (except for plaster)	Pottery, tile and brick making	c or n
	Overalls (protective)	Clothing	c
	Pit props (for temporary shafts)	Mining	c
	Printing plates and stereos	Packaging (excluding plastic packaging)	c or r
	Printing plates and stereos	Printing and photographic	c or r
	Protective clothing (not elsewhere specified)	Clothing	c
	Saw blades, drill bits and the like	Timber and joinery industries	c or r
	Saw blades	Contractors, builders and quarrying	c or r
	Smocks (protective)	Clothing	c
	Stationery	Office equipment and furniture	c
	Tapes	Computers	c or n *
	Uniforms	Clothing	c
Determination DEP8: Tax Depreciation Rates General Determination Number 8	Drill bits, saw blades and the like	Medical and medical laboratory equipment, or scientific and laboratory equipment	c or r
Determination DEP17: Tax Depreciation Rate General Determination Number 17	Hydraulic hoses	Undersea maintenance	c or r
Determination DEP32: Tax Depreciation Rates General Determination Number 32	Newspapers and periodicals (if not to be held).	Books, music, and manuscripts	c

* The Commissioner is considering whether to update the "Computer" asset category in view of the length of time since the depreciation rates for this industry were set (1992) and the advancement in technology since then. If the update proceeds, the Commissioner will be consulting with the industry and, before any new rates (if any) are set, all taxpayers will have the opportunity to comment through the department's public consultative process.

INTERPRETATION STATEMENTS

IS 08/03: RESOURCE CONSENT APPLICATION FEES AND PROVISION OF WORKS, PROVISION OF INFORMATION AND TRANSFER OF LAND AS CONDITIONS OF RESOURCE CONSENT—GST TREATMENT

Introduction

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

1. Resource consent may be required for the use of land or other natural resources. A resource consent may be granted subject to conditions, including conditions requiring the consent holder to provide services or works, provide information relating to the exercise of a resource consent (such as information relating to measurements and tests required as a condition of a water discharge permit or an emission consent), or to transfer land.
2. Examples of conditions relating to the provision of services or works include:
   - a requirement to plant trees along a boundary to reduce the visual impact of a piggery activity: *Ebben v Manuwatu-Wanganui Regional Council* [1994] NZRMA 115
   - a requirement to replant an orchard, upgrade packing facilities, attend to drainage work and clear up rubbish: *Auckland Regional Council v Rodney District Council* [1994] NZRMA 428
   - a requirement that the applicant for a fertiliser works consent purchase farms affected by the proposal and owned by objectors if requested to do so within a three-year period: *Lange v Town and Country Planning Appeal Board (No 2)* [1967] NZLR 898
   - a condition requiring the construction of a road: *Waitakere City Council v Estate Homes Ltd* [2007] 2 NZLR 149.
3. The relevant local authority deals with applications for resource consent.
4. A fee is payable in respect of applications for resource consent.
5. The purpose of this interpretation statement is to consider the GST treatment of:
   - fees payable in respect of applications for resource consent
   - the provision of services or works required as a condition of resource consent
   - the provision of information as a condition of resource consent

Summary

Resource consent application fees

6. Resource consent application fees are consideration for the supply of services (considering and making a decision on an application for resource consent) by a local authority. GST is chargeable on the fees.

Provision of works

7. Local authorities do not make a supply of goods or services for the provision of works required as a condition of resource consent.
8. If a resource consent is exercised and works required as a condition of resource consent are carried out, a supply of services may be made by the consent holder but this is not necessarily so in all cases. If a consent holder makes a supply of services by carrying out works, consideration is not given for the supply in the form of the grant of resource consent or for the supply of any other services by a local authority. GST is not chargeable on the supply of the provision of works by a consent holder who is registered for GST (that is, a registered person).
9. If a local authority pays compensation to a consent holder for works required as a condition of resource consent over and above the requirements of the activity for which consent is given, the compensation is consideration for the supply of services by the consent holder. If the consent holder is a registered person and the activity in respect of which the consent is given is carried out in the course or furtherance of a taxable activity, GST is chargeable on the compensation paid.
10. If the activity in respect of which consent is granted is part of a taxable activity carried out by the applicant and the activity could not be carried out unless works required as a condition of resource consent are provided, an input tax credit is allowable in respect of goods and services acquired in order to carry out such works.

Provision of information

11. Local authorities do not supply goods or services for the provision of information required as a condition of resource consent.
12. The provision of information under a condition of resource consent does not constitute a supply of services by a consent holder.

Transfer of land

13. A local authority that grants subdivision consent subject to the transfer of land does not supply resource consent or any other services for the supply of land by the applicant. The transfer of land required as a condition of subdivision consent is not consideration for a supply of goods or services by a local authority.
14. The consideration for the transfer of the land as a condition of subdivision consent is the compensation paid by a local authority for the land (including any additional survey costs in respect of an esplanade reserve or esplanade strip over and above the survey costs that the applicant is required to incur in respect of the subdivision).
15. If the subdivider is a registered person and the supply of land is made in the course or furtherance of their taxable activity, GST is chargeable on the compensation received.
16. The local authority is entitled to a credit for input tax (GST charged on the supply of the land by a registered person or input tax in terms of section 3A(2)) on the compensation paid.

Background

Nature of resource consent

17. The Resource Management Act 1991 ("RMA") prohibits the use of land or other natural resources in a manner that contravenes a rule in a district plan or proposed district plan (or regional plan or proposed regional plan) unless the activity is permitted by a resource consent or the activity is an existing use: sections 9, 11, 12, 13, 15 and 15A–15C of the RMA.
18. A resource consent permits the consent holder to do something that would otherwise contravene a provision of the RMA restricting the use of land, the subdivision of land, the use of water rights or the discharge of contaminants or waste: section 87 of the RMA. A resource consent is neither real nor personal property: section 122(1) of the RMA.
19. Generally, a resource consent commences when the time for lodging appeals against the granting of the consent has expired and no appeals have been lodged, or any appeal that has been lodged has been determined or withdrawn: section 116 of the RMA. A resource consent lapses on the date specified in the consent or, if no date is specified, five years after the date of commencement of the consent unless the consent has been given effect to or an extension of the consent has been granted: section 125 of the RMA.

Local authority's obligations

20. Applications for resource consent must be made to the relevant local authority: section 88(1) of the RMA.
21. The process that the local authority is required to follow in dealing with applications for resource consent is specified in the RMA.
22. The local authority's district plan or regional plan is the framework within which resource consent applications are considered. The rules in a district plan take effect as regulations: section 76(2) of the RMA. Sections 104A to 104D of the RMA permit different degrees of control for different categories of activities. A district plan or regional plan determines whether an activity is a permitted activity, prohibited activity, controlled activity, discretionary activity or non-complying activity.
23. Section 77C of the RMA specifies that certain types of activity are prohibited activities. A resource consent is not required for a permitted activity and resource consent cannot be given for a prohibited activity: section 77B(1) and (7) of the RMA.
24. A consent authority has discretion as to whether to grant consent to discretionary or non-complying activities. If consent is granted for such activities, the authority may impose conditions: sections 77B(4) and (5) and 104B of the RMA.
25. A consent authority must grant a resource consent for a controlled activity "unless it has insufficient information to determine whether or not the activity is a controlled activity" and may impose conditions in respect of matters specified in its district plan or regional plan: sections 77B(2)(aa), (b) and (c) and 104A of the RMA. See *Discount Brands Ltd v Westfield (NZ) Ltd* [2005] NZLR 597.
26. Notice of a decision granting resource consent must be given within the time limit specified in section 115 of the RMA.

Conditions

27. Section 108(1) of the RMA provides that "except as expressly provided in this section and subject to any regulations" a resource consent may be granted on "any condition that the consent authority considers appropriate", including any condition of the kind referred to in section 108(2). The conditions referred to in section 108(2) include the following.

    - A condition requiring that a financial contribution be made. A "financial contribution" may be made in the form of money or land and money: see the definition of "financial contribution" in section 108(9) of the RMA.
      Where a local authority requires a financial contribution as a condition of resource consent under the RMA, the local authority makes a supply to the person who provides the financial contribution: section 5(7B). If a person makes a financial contribution in the form of land, the person is treated as supplying goods or services to the local authority: section 5(7C).
    - A condition requiring that services or works (including the protection, planting or replanting of any tree or other vegetation or the protection, restoration or enhancement of any natural or physical resource) be provided: section 108(2)(c) of the RMA.
    - In respect of a subdivision consent, a condition requiring the creation of an esplanade reserve or an esplanade strip: sections 108(2)(f) and 220 of the RMA. Land contributed for an esplanade reserve or esplanade strip as a condition of a subdivision consent is not a financial contribution: see definition of "financial contribution" in section 108(9) of the RMA.

28. A local authority may also include as a condition of resource consent a requirement that the consent holder supply to the local authority information relating to the exercise of the resource consent: section 108(3) of the RMA.

29. Conditions imposed under section 108(2) of the RMA must be for the purpose of the RMA, must fairly and reasonably relate to the permitted activity and must not be unreasonable: *Waitakere City Council v Estate Homes Ltd* [2007] 2 NZLR 149.

30. Section 108 of the RMA does not permit the imposing of a condition that has the effect that the resource consent will not be in existence until the condition is fulfilled: *Director-General of Conservation v Marlborough District Council* [2004] 3 NZLR 127 (at para 16).

Fees

31. Section 36(1)(b) of the RMA permits local authorities to fix the charges payable by applicants for resource consent "for the carrying out of its functions in relation to the receiving, processing and granting of resource consents". The scale for application fees for resource consent is set by the relevant local authority following public consultation: *Harrison v Northland Regional Council* 28 October 2003, Environment Court W67-03. A local authority may require the payment of an additional charge if the charge fixed under section 36(1)(b) of the RMA is inadequate to enable a local authority to recover its actual and reasonable costs: section 36(3) of the RMA. However, a local authority cannot recover more than its reasonable costs in dealing with a resource consent application: section 36(4) of the RMA.

32. Section 36(7) of the RMA authorises a local authority to refuse to take further steps in relation to a resource consent application until outstanding fees in relation to the application have been paid.

Legislation

Goods and Services Tax Act 1985

33. "Consideration" is defined in section 2(1) as follows.

> **Consideration**, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body:

34. Section 3A provides:

> (1) Input tax, in relation to a registered person, means—
>
> (a) Tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies:
>
> (b) Tax levied under section 12(1) of this Act on goods entered for home consumption under the Customs and Excise Act 1996 by that person, being goods applied or acquired for the principal purpose of making taxable supplies:
>
> (c) An amount determined under subsection (3) after applying subsection (2).
>
> (2) In the case of a supply by way of sale to a registered person of secondhand goods situated in New Zealand, the amount of input tax is determined under subsection (3) if—
>
> (a) The supply is not a taxable supply; and

(b) The goods are not supplied by a supplier who—
(i) Is a non-resident; and
(ii) Has previously supplied the goods to a registered person who has entered them for home consumption under the Customs and Excise Act 1996; and

(c) The goods are acquired for the principal purpose of making taxable supplies and—

(i) The taxable supplies are not charged with tax at the rate of 0% under section 11A(1)(q) or (r); or

(ii) The taxable supplies are charged with tax at the rate of 0% under section 11A(1)(q) or (r) and the goods have never, before the acquisition, been owned or used by the registered person or by a person associated with the registered person.

(3) The amount of input tax is—

(a) If the supplier and the recipient are associated persons, the lesser of—

(i) The tax included in the original cost of the goods to the supplier; and

(ii) The tax fraction of the purchase price; and

(iii) The tax fraction of the open market value of the supply; or

(b) If the supplier and the recipient are associated persons and the supplier is deemed to have made a supply of the goods under section 5(3) that has been valued under section 10(7A), the lesser of—

(i) The tax fraction of the open market value of the deemed supply under section 5(3); and

(ii) The tax fraction of the purchase price; and

(iii) The tax fraction of the open market value of the supply; or

(c) If the supplier and the recipient are associated persons and the supplier is deemed to have made a supply of the goods under section 5(3) that has been valued under section 10(8), the lesser of—

(i) The tax fraction of the valuation under section 10(8) of the deemed supply under section 5(3); and

(ii) The tax fraction of the purchase price; and

(iii) The tax fraction of the open market value of the supply; or

(d) If the supplier and the recipient are not associated persons and the supply is not the only matter to which the consideration relates, the lesser of—

(i) The tax fraction of the purchase price; and

(ii) The tax fraction of the open market value of the supply; or

(e) In all other cases, the tax fraction of the consideration in money for the supply.

(4) For the purpose of subsection (1)(b), applied does not include—

(a) The delivery or the arranging of the delivery of the goods to a person in New Zealand; or

(b) The making of the delivery of the goods to a person in New Zealand more easily achieved.

(4A) For the purpose of subsections (1) and (2), if a supply of goods and services acquired by a non-profit body is not acquired for the principal purpose of making exempt supplies, the supply is treated as being acquired for the principal purpose of making taxable supplies.

35. Section 5(7B) and (7C) provide:

(7B) For the purposes of this Act, a local authority is treated as supplying goods and services to a person if the local authority requires a contribution from the person as—

(a) A financial contribution that is a condition of a resource consent under the Resource Management Act 1991:

(b) A development contribution under the Local Government Act 2002.

(7C) For the purposes of this Act, a person who makes a contribution to a local authority is treated as supplying goods and services to the local authority to the extent that the contribution consists of land and is—

(a) A financial contribution that is a condition of a resource consent under the Resource Management Act 1991:

(b) A development contribution under the Local Government Act 2002.

36. Section 6(1) provides:

(1) For the purposes of this Act, the term taxable activity means—

(a) Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:

(b) Without limiting the generality of paragraph (a) of this subsection, the activities of any public authority or any local authority.

37. Section 8(1) provides:

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

38. Section 20(3)(a) and (b) provides:

(3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period—

(a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount of the following:

(i) Input tax in relation to the supply of goods and services (not being a supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies), made to that registered person during that taxable period:

(ia) Input tax in relation to the supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies, to the extent that a payment in respect of that supply has been made during that taxable period:

(ii) Input tax invoiced or paid, whichever is the earlier, pursuant to section 12 of this Act during that taxable period:

(iii) Any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b); and

(b) In the case of a registered person who is required to account for tax payable on a payments basis or a hybrid basis pursuant to section 19 of this Act, the amount of the following:

(i) Input tax in relation to the supply of goods and services made to that registered person, being a supply of goods and services which is deemed to take place pursuant to section 9(1) or section 9(3)(a) or section 9(3)(aa) or section 9(6) of this Act, to the extent that a payment in respect of that supply has been made during the taxable period:

(ii) Input tax paid pursuant to section 12 of this Act during that taxable period:

(iii) Input tax in relation to the supply of goods and services made during that taxable period to that registered person, not being a supply of goods and services to which subparagraph (i) of this paragraph applies:

(iv) Any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b), to the extent that a payment has been made in respect of that amount; and

Resource Management Act 1991

39. Section 36 of the RMA provides:

(1) A local authority may from time to time, subject to subsection (2), fix charges of all or any of the following kinds:

(a) Charges payable by applicants for the preparation or change of a policy statement or plan, for the carrying out by the local authority of its functions in relation to such applications:

(b) Charges payable by applicants for resource consents, for the carrying out by the local authority of its functions in relation to the receiving, processing, and granting of resource consents (including certificates of compliance and existing use certificates):

(c) Charges payable by holders of resource consents, for the carrying out by the local authority of its functions in relation to the administration, monitoring, and supervision of resource consents (including certificates of compliance and existing use certificates), and for the carrying out of its resource management functions under section 35:

(ca) charges payable by persons seeking authorisations under Part 7A, for the carrying out by the local authority of its functions in relation to the allocation of authorisations (whether by tender or any other method), including its functions preliminary to the allocation of authorisations:

(cb) charges payable by holders of resource consents, for the carrying out by the local authority of its functions in relation to reviewing consent conditions, if—

(i) the review is carried out at the request of the consent holder; or

(ii) the review is carried out under section 128(1)(a); or

(iii) the review is carried out under section 128(1)(c):

(d) Charges payable by requiring authorities and heritage protection authorities, for the carrying out by the local authority of its functions in relation to designations and heritage orders:

(e) Charges for providing information in respect of plans and resource consents, payable by the person requesting the information:

(f) Charges for supply of documents, payable by the person requesting the document:

(g) Any kind of charge authorised for the purposes of this section by regulations.

Charges fixed under this subsection shall be either specific amounts or determined by reference to scales of charges or other formulae fixed by the local authority.

(2) Charges may be fixed under subsection (1) only—

(a) in the manner set out in section 150 of the Local Government Act 2002; and

(b) after using the special consultative procedure set out in section 83 of the Local Government Act 2002; and

(c) in accordance with subsection (4).

(3) Where a charge fixed in accordance with subsection (1) is, in any particular case, inadequate to enable a local authority to recover its actual and reasonable costs in respect of the matter concerned, the local authority may require the person who is liable to pay the charge, to also pay an additional charge to the local authority.

(3A) A local authority must, upon request by any person liable to pay a charge under this section, provide an estimate of any additional charge likely to be imposed under subsection (3).

(4) When fixing charges referred to in this section, a local authority shall have regard to the following criteria:

(a) The sole purpose of a charge is to recover the reasonable costs incurred by the local authority in respect of the activity to which the charge relates:

(b) A particular person or persons should only be required to pay a charge—

(i) To the extent that the benefit of the local authority's actions to which the charge relates is obtained by those persons as distinct from the community of the local authority as a whole; or

(ii) Where the need for the local authority's actions to which the charge relates is occasioned by the actions of those persons; or

(iii) In a case where the charge is in respect of the local authority's monitoring functions under section 35(2)(a) (which relates to monitoring the state of the whole or part of the environment), to the extent that the monitoring relates to the likely effects on the environment of those persons' activities, or to the extent that the likely benefit to those persons of the monitoring exceeds the likely benefit of the monitoring to the community of the local authority as a whole,—

and the local authority may fix different charges for different costs it incurs in the performance of its various functions, powers, and duties under this Act—

(c) In relation to different areas or different classes of applicant, consent holder, requiring authority, or heritage protection authority; or

(d) Where any activity undertaken by the persons liable to pay any charge reduces the cost to the local authority of carrying out any of its functions, powers, and duties.

(5) A local authority may, in any particular case and in its absolute discretion, remit the whole or any part of any charge of a kind referred to in this section which would otherwise be payable.

(6) Sections 357B to 358 (which deal with rights of objection and appeal against certain decisions) shall apply in respect of the requirement by a local authority to pay an additional charge under subsection (3).

(7) Where a charge of a kind referred to in subsection (1) is payable to a local authority, the local authority need not perform the action to which the charge relates until the charge has been paid to it in full.

40. Section 108(2)(a), (c) and (f) of the RMA provides:

A resource consent may include any one or more of the following conditions:

(a) Subject to subsection (10), a condition requiring that a financial contribution be made:

...

(c) A condition requiring that services or works, including (but without limitation) the protection, planting, or replanting of any tree or other vegetation or the protection, restoration, or enhancement of any natural or physical resource, be provided:

...

(f) In respect of a subdivision consent, any condition described in section 220 (notwithstanding any limitation on the imposition of conditions provided for by section 77B(2)(c) or (3)(c)):

41. Section 108(3) and (4) of the RMA provides:

(3) A consent authority may include as a condition of a resource consent a requirement that the holder of a resource consent supply to the consent authority information relating to the exercise of the resource consent.]

(4) Without limiting subsection (3), a condition made under that subsection may require the holder of the resource consent to do one or more of the following:

(a) To make and record measurements:

(b) To take and supply samples:

(c) To carry out analyses, surveys, investigations, inspections, or other specified tests:

(d) To carry out measurements, samples, analyses, surveys, investigations, inspections, or other specified tests in a specified manner:

(e) To provide information to the consent authority at a specified time or times:

(f) To provide information to the consent authority in a specified manner:

(g) To comply with the condition at the holder of the resource consent's expense.

42. "Financial contribution" is defined in section 108(9) of the RMA as follows.

(9) In this section, **financial contribution** means a contribution of—

(a) Money; or

(b) Land, including an esplanade reserve or esplanade strip (other than in relation to a subdivision consent), but excluding Māori land within the meaning of the Māori Land Act 1993 unless that Act provides otherwise; or

(c) A combination of money and land.

43. The conditions described in section 220 of the RMA include:

(a) Where an esplanade strip is required under section 230, a condition specifying the provisions to be included in the instrument creating the esplanade strip under section 232:

(aa) A condition requiring an esplanade reserve to be set aside in accordance with section 236:

(ab) A condition requiring the vesting of ownership of land in the coastal marine area or the bed of a lake or river in accordance with section 237A:

(ac) A condition waiving the requirement for, or reducing the width of, an esplanade reserve or esplanade strip in accordance with section 230 or section 405A:

Analysis

44. GST is chargeable on the supply of goods and services in the course of a taxable activity carried on by a registered person by reference to the value of the supply: section 8(1). The value of the supply is the consideration paid for the supply. The activities of a local authority constitute a taxable activity: section 6(1).

45. Local authorities are registered persons for GST purposes. Applicants for resource consent may also be registered persons.

46. An input tax credit is allowable in respect of goods or services acquired for the principal purpose of making taxable supplies: sections 3A and 20(3). "Purpose" means "the object which the taxpayer has in mind or in view": *CIR v BNZ Investment Advisory Services Ltd* (1994) 16 NZTC 11,111; *Norfolk Apartments Ltd v CIR* (1995) 17 NZTC 12,003; *Wairakei Court Ltd v CIR* (1999) 19 NZTC 15,202.

47. A principal purpose is the "main or primary or fundamental" purpose: *CIR v BNZ Investment Advisory Services Ltd; Coveney v CIR* (1994) 16 NZTC 11,328; Case T39 (1997) 18 NZTC 8,261; *Norfolk Apartments Ltd v CIR*.

Consideration

48. A fundamental principle of GST is that it is a tax on transactions. Therefore, not all payments received by a registered person will necessarily be consideration for GST purposes. GST is imposed on supplies, so it is necessary to identify a supply before there can be a liability for GST. For a payment to be consideration, there must be a sufficient connection between the payment and a supply: *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187, 13,193.

49. To determine whether a payment is consideration for GST purposes, it is necessary to consider the legal nature of the arrangement between the parties. In Chatham Islands *Enterprise Trust v CIR* (1999) 19 NZTC 15,075, Blanchard J said (at para 17):

> Although the linkage or nexus between a payment and the activity to which it gives rise may be very broad, it is still necessary to have regard to the legal form which is being employed:
>
> > ... in taxation disputes the Court is concerned with the legal arrangements actually entered into ... not with the economic or other consequences of the arrangements.
>
> ([*CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187, 13,192, citing *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694, 706, also reported as *Marac Life Assurance Ltd v CIR; CIR v Marac Life Assurance Ltd* (1986) 8 NZTC 5086 at pp 5,097, 5098]). The tax being one on transactions, it is necessary to pay close attention to the legal nature of what has been done. The Crown does not of course suggest that it set up the transaction in a way which disguised or distorted its real nature.

50. There need not be a contract between the parties. The supply also need not be made to the person providing the consideration. See T*urakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032.

51. The statutory definition of "consideration" includes, but is wider than, the contract law meaning of the term. However, the statutory definition of "consideration" (like the contract law definition) requires an element of reciprocity: *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147.

52. Therefore:

- to determine whether a payment is consideration, it is necessary to consider the legal nature of the arrangement between the parties
- for a payment to be consideration, it is necessary to identify a supply and establish a sufficient relationship between the payment and the supply
- there need not be a contract between the parties, and the supply need not be made to the person providing the consideration.

Whether fees payable in respect of applications for resource consent are consideration for a supply by local authorities

53. Section 36(1)(b) of the RMA permits a local authority to recover costs incurred in carrying out its administrative functions in relation to a resource consent (including certificates of compliance and existing use certificates). Existing use certificates and certificates of compliances are treated as if they are resource consents: sections 139(6) and 139A(9) of the RMA. The charges referred to in section 36(1)(b) of the RMA relate to all steps a local authority must carry out in the course of dealing with an application for resource consent: *Wellington Regional Council v Aifric Developments* (1996) 2 ELRNZ 265.

54. The fee payable in respect of applications for resource consent is not paid for the grant of resource consent. A fee is payable whether or not resource consent is granted: *Harrison v Northland Regional Council* (at para 17).

55. A local authority has a duty under the RMA to consider whether to grant resource consent and whether a resource consent should be subject to conditions

having regard to the matters specified in section 104 of the RMA. Where an application for resource consent is made and the fee payable by applicants for resource consent is paid, a local authority has an obligation to consider and make a decision on the application in accordance with the procedure prescribed in the RMA. The fee is consideration for the supply of services (that is, considering and making a decision on the application) by the local authority.

56. GST is chargeable on the fees. If the applicant is registered for GST and applied for resource consent for an activity that is part of their taxable activity, they are entitled to an input tax credit in respect of the fees.

57. This conclusion is consistent with the conclusion in Question We've Been Asked "Building permit fees" *Tax Information Bulletin* Vol 4, No 8 (April 1993), p 13, which states that GST is chargeable on building permit fees (a similar transaction to the payment of resource consent application fees).

Whether provision of works is consideration for a supply by a local authority

58. Section 108 of the RMA does not permit the imposing of a condition that has the effect that a resource consent is not effective until the condition is fulfilled: *Director-General of Conservation v Marlborough District Council* (at para 16).

59. A resource consent may lapse (if the consent is not "given effect to" within the period specified in the consent or in section 125 of the RMA) without the works having been carried out. A resource consent gives the holder the right to carry out the activity permitted by the resource consent. However, the consent holder is not obliged to carry out that activity.

60. If a condition is imposed in respect of a resource consent requiring the provision of services or works, the condition relates to the applicant's ability to carry out the activities for which consent is granted: *Director-General of Conservation v Marlborough District Council* (at para 17). In other words, if the holder of a resource consent exercises the resource consent, the consent holder must comply with the terms of the resource consent. A local authority may apply to the Environment Court for an enforcement order if a condition of a resource consent has been breached: sections 314 and 316 of the RMA.

61. A local authority is not entitled to retain a financial contribution if the activity permitted by a resource consent does not proceed: section 110 of the RMA. It would be inconsistent with section 110 of the RMA if a local authority could require the provision of works under a condition of resource consent if the activity permitted by the resource consent is not carried out. The provision of services and works is required to avoid, remedy or mitigate the adverse effects of the permitted activity. These adverse effects will not eventuate if the activity is not carried out.

62. Resource consents are granted subject to conditions rather than for the performance of conditions. This distinction is similar to the distinction under contract law between consideration and a condition: *Thomas v Thomas* (1842) 2 QB 851.

63. The consent holder's right to exercise the resource consent is conditional on the provision of works, but the provision of works is not consideration for resource consent or a supply of any other nature by the local authority. A resource consent takes effect and remains in existence for the duration of the resource consent regardless of whether works under a condition of the resource consent are carried out. Consent holders are obliged to carry out works required as a condition of resource consent only if they exercise the resource consent. A resource consent may lapse without the works required as a condition of the consent having been carried out. A local authority does not undertake any specific obligations in return for the provision of services or works. Therefore, the Commissioner considers that services or works required as a condition of resource consent are not consideration for the grant of resource consent or for a supply of any other nature by a local authority.

64. Specific legislation was required in order to make it clear that a requirement for the provision of a financial contribution as a condition of resource consent gives rise to a supply by the local authority and that the provision of a financial contribution gives rise to a supply by the person providing the financial contribution: section 5(7B) and (7C). Sections 5(7B) and 5(7C) were intended to apply only to contributions made in the form of money and/or land (ie, "financial contributions" as defined in section 108(9) of the RMA). Sections 5(7B) and 5(7C) were not intended to apply to other types of conditions imposed under the RMA. Other types of conditions were omitted from the amendments because of the difficulty of valuing non-monetary contributions and because it was considered that the value of such contributions would not be significant: Inland Revenue Department and The Treasury (2003) *Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions) Bill 2003: Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill*, Wellington:

Inland Revenue Department and The Treasury, available at http://taxpolicy.ird.govt.nz/publications/files/offrep03.doc. Therefore, it was accepted that non-monetary conditions imposed in respect a resource consent would not result in a supply by the local authority.

Whether provision of works is a supply by the consent holder for consideration

65. **If a resource consent is exercised, works required as a condition of resource consent must be carried out. The provision of works or services as a condition of resource consent could constitute a supply by the consent holder but this is not necessarily so in all cases. Although "services" is widely defined, for services to be supplied, there must be some action that helps or benefits the recipient: Case S65 (1996) 17 NZTC 7,408; *F B Duvall Ltd v C of IR* (1997) 18 NZTC 13,470. Generally works undertaken as a condition of resource consent are necessitated solely by the carrying out of the activity permitted by the consent. Therefore, it could be argued that services are not supplied by the consent holder as the provision of works is carried out for the consent holder's own benefit (being undertaken to enable the activity permitted by the resource consent to be carried out).**

66. For the provision of works to be subject to GST, consideration must be provided for the provision works in the form of money or in the form of a supply of goods or services by the local authority. **Consideration need not be in the form of money: section 10(2). GST applies to barter transactions: *Case T61* (1998) 18 NZTC 8,461; *Lanauze v King* (2001) 20 NZTC 17,360. Under a barter transaction, the supply of goods or services by one party is the consideration for the supply by the other party. If a local authority does not make payments of cash to a consent holder who has provided works or services, information or transferred land to the local authority, it is necessary to consider whether the local authority has provided consideration in the form of a supply of goods or services to the consent holder.**

67. As local authorities do not grant resource consent and do not undertake any obligations for the provision of works, it follows that local authorities do not provide non-monetary consideration in the form of a supply of goods or services for the provision of works required as a condition of resource consent.

68. There may be circumstances where a consent holder receives consideration in the form of money from a local authority for the provision of works. In *Waitakere City Council v Estate Homes Ltd* the council paid compensation to a developer because the developer was required to carry out work in excess of the requirements of the development for which consent had been given. The payment of such compensation was required in order to make the condition reasonable.

69. If a consent holder receives compensation for carrying out works in excess of the requirements of the activity for which consent was given, the compensation is consideration for a supply of services by the consent holder. Such compensation is subject to GST, if the consent holder is a registered person and the activity in respect of which the consent was given was carried out in the course of furtherance of a taxable activity. However, in the absence of a payment in cash by the local authority, as a local authority does not supply goods or services for the provision of works, the supply of works by a consent holder would not be a supply for consideration (in the form of a supply of goods or services) provided by the local authority.

70. If the activity in respect of which consent is granted is part of a taxable activity carried out by the applicant and the activity could not be carried out unless works required as a condition of resource consent were provided, an input tax credit is allowable in respect of goods and services acquired in order to carry out such works. In such circumstances, although the provision of works may not be a taxable supply, the fundamental purpose of the acquisition of the goods and services is to enable the applicant to carry out the activity. On that basis, the goods and services would be acquired for the principal purpose of the taxable activity.

Whether provision of information is consideration for a supply by the local authority

71. A condition requiring the consent holder to supply to the local authority information relating to the exercise of the resource consent may (among other things) require the consent holder to make and record measurements; take and supply samples; carry out analyses, surveys, investigations, inspections or other tests; and provide information to the local authority: section 108(4) of the RMA. This information is to be provided at the cost of the consent holder: section 108(4)(g) of the RMA. A requirement to supply information on an ongoing basis could be appropriate, for example, to a water discharge permit or an emission consent.

72. A local authority has a statutory obligation to monitor the exercise of resource consents in its area and to take appropriate action: section 35(2)(d) of the RMA;

Woodland Farms (Ruawai) Ltd v Otamatea County Council 18 September 1985, Planning Tribunal A65/85, at p 4.

73. Under section 36(1)(c) of the RMA a local authority is entitled to charge a fee to holders of resource consents in relation to the carrying out of its functions under section 35 of the RMA.

74. The RMA contemplates self-monitoring by the holder of a resource consent, and a consent holder must establish that the exercise of the consent complies with the conditions of the consent: *Juken Nissho Ltd v Northland Regional Council* [2000] 2 NZLR 556 (at para 36).

75. The purpose of a condition requiring the provision of information relating to the exercise of a resource consent is to enable the local authority to adequately police compliance with the terms of a consent: *Alliance Freezing Co v Southland Catchment Board* (1977) 6 NZTPA 247, 255; *Juken Nissho Ltd v Northland Regional Council* (at para 17).

76. Although the obligation of a local authority to police compliance with the terms of a resource consent is a separate and possibly more onerous obligation, local authorities have a right to charge holders of resource consents a fee to cover their costs in carrying out their monitoring function: section 36(1)(c) of the RMA.

77. For similar reasons to those outlined above, the Commissioner considers that the provision of information by the holder of a resource consent under a condition of resource consent is not consideration for the supply of a resource consent or for a supply of any other nature. No specific obligations are undertaken by a local authority for the provision of information.

Whether provision of information is a supply by the consent holder for consideration

78. The Commissioner also considers that the consent holder does not supply services (in the form of the provision of information) to a local authority. The holder of a resource consent has an obligation to "self-monitor" compliance with the terms of a resource consent. .

Consideration for the transfer of land as a condition of subdivision consent

79. Local authorities are authorised to grant subdivision consents subject to any of the conditions described in section 220 of the RMA. These conditions relate to the creation of esplanade strips or esplanade reserves, the vesting of ownership of land in the coastal marine area or in the bed of a lake or river, or the waiving of a requirement for or reducing the width of an esplanade reserve or esplanade strip. A condition relating to the creation of an esplanade reserve or esplanade strip is imposed in order to avoid, remedy or mitigate the adverse effects of development and to meet the sustainable management objectives of the RMA: *MacDonald v Christchurch City Council* 3 October 2002, Environment Court C121/2002, at para 101.

80. Land for an esplanade reserve is transferred to the local authority. When an esplanade strip is created, an interest in land is conferred on the local authority. In some circumstances, land is transferred to the Crown as a condition of resource consent: see sections 231(1), 232 and 237A of the RMA.

81. Compensation is not payable when the allotment created by the subdivision is smaller than four acres: section 237E of the RMA. In other cases the amount of the compensation payable for the land or interest in land is to be agreed between the parties: sections 237E–237G of the RMA. If the parties are unable to agree on the amount of the compensation, the amount is to be determined in accordance with the procedure specified in section 237H of the RMA. Any additional survey costs required in connection with the creation of an esplanade reserve or esplanade strip are to be taken into account in determining the compensation payable: section 237H(4) of the RMA.

82. A local authority that grants subdivision consent subject to the transfer of land does not supply resource consent or any other services for the transfer of land. The consideration for the transfer of land as a condition of subdivision consent is the compensation agreed between the parties or determined in accordance with the procedure in section 237H of the RMA (including any additional survey costs in respect of the esplanade reserve or esplanade strip over and above the survey costs that the applicant is required to incur in respect of the subdivision).

83. Accordingly, if the subdivider is a registered person and the supply of land is made in the course or furtherance of their taxable activity, GST is chargeable on the compensation received. The local authority is entitled to a credit for input tax (GST charged on the supply of the land by a registered person or input tax in terms of section 3A(2)) on the compensation paid as the land is acquired for the principal purpose of the local authority's 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 their 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**

ASSOCIATED PERSONS TEST – TIMING IN RELATION TO GROSS INCOME DERIVED FROM THE SALE OR OTHER DISPOSITION OF LAND

BR Pub 03/05 applied from 1 July 2003 to 30 June 2008. It was a reissue of BR Pub 00/05, which applied from 1 July 2000 to 30 June 2003. Since the ruling was reissued, the Income Tax Act 1994 has been repealed and replaced with the Income Tax Act 2004, which has also now been repealed and replaced with the Income Tax Act 2007.

The provisions in the Income Tax Act 2004 (sections CB 6 – CB 9) and the Income Tax Act 2007 (section CB 7 and sections CB 9 – CB 11) clearly provide that the associated persons test is to be applied at the time land is acquired or, in the case of builders undertaking improvements, at the time that improvements are begun.

As a result of these amendments clarifying the timing of the application of the associated persons test, BR Pub 03/05 will not be reissued.

PUBLIC RULING BR PUB 08/02: MĀORI TRUST BOARDS: DECLARATION OF TRUST FOR CHARITABLE PURPOSES MADE UNDER SECTION 24B OF THE MĀORI TRUST BOARDS ACT 1955 – INCOME TAX CONSEQUENCES

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 01/07 which was published in *Tax Information Bulletin* Vol 13, No 7 (July 2001). BR Pub 01/07 was a reissue of BR Pub 97/8 which was published in *Tax Information Bulletin* Vol 9, No 8 (August 1997). This ruling has been updated to take into account the Charities Act 2005 and also applies the Income Tax Act 2007, which came into force on 1 April 2008. The changes between the provisions in the Income Tax Act 1994 and the Income Tax Act 2007 do not affect the conclusions previously reached. BR Pub 01/07 expired on 31 March 2006. BR Pub 08/02 applies for an indefinite period beginning on the first day of the 2008/09 income year.

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

All legislative references are to the Income Tax Act 2007, unless otherwise stated.

This ruling applies in respect of sections CW 41 and CW 42.

The arrangement to which this ruling applies

The arrangement is the derivation of income by a trust established by a Māori Trust Board pursuant to the execution of a declaration of trust, under section 24B(1) of the Māori Trust Boards Act 1955, declaring that it stands possessed of any of its property upon trust for charitable purposes.

How the taxation law applies to the arrangement

When a Māori Trust Board executes a declaration of trust that it shall stand possessed of property for charitable purposes, under section 24B(1) of the Māori Trust Boards Act 1955, the income of such a trust is exempt from income tax under section CW 41 or section CW 42 if:

- all the purposes specified in the declaration of trust are purposes that are specified in section 24 or section 24A of the Māori Trust Boards Act 1955, and
- the Commissioner is satisfied that, with the exception of the charitable purpose requirement and the public benefit test, all other requirements of charitable status are met, and
- the declaration of trust has been submitted to and approved by the Commissioner, as required by section 24B(3) of the Māori Trust Boards Act 1955, and
- the trust is registered as a charitable entity under the Charities Act 2005, or has started the registration process before 1 July 2008 provided the trust is not notified by the Commissioner of Inland Revenue that the entity is not a tax charity as defined in the Act.

The period for which this ruling applies

This ruling will apply for an indefinite period beginning on the first day of the 2008/09 income year.

This ruling is signed by me on the 31st day of July 2008.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 08/02

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 08/02 ("the ruling").

Overview

Sections CW 41 and CW 42 provide the following exemptions from income tax for income derived by a charitable trust.

- Under section CW 41, income derived by trustees in trust for charitable purposes or by any institution or society established and maintained exclusively for charitable purposes.
- Under section CW 42, income derived from a business carried on by trustees in trust for charitable purposes or by any institution or society established exclusively for charitable purposes.

Neither exemption is available if any person is able to influence the amount of any private pecuniary benefit from the trust. The exemption under section CW 42 applies only to the extent that the charitable purposes are carried out in New Zealand.

Under section 24B of the Māori Trust Boards Act 1955, a Māori Trust Board may declare that it holds property in trust for charitable purposes. The income of the trust can be applied only for those purposes set out in sections 24 and 24A of that Act and which are specified in the declaration of trust. Section 24B deems the income of such a trust to be income derived by trustees in trust for charitable purposes for the purposes of the Income Tax Act.

As of 1 July 2008, the Charities Act 2005 amends sections CW 41 and CW 42 limiting the application of these sections to trusts, societies or institutions that register as charitable entities. An entity, including a trust established by a Māori Trust Board pursuant to section 24B of the Māori Trust Boards Act, must be registered with the Charities Commission to be eligible to receive tax exemptions under section CW 41 or CW 42. Also included are trusts that have started the registration process before 1 July 2008, that intend to complete the process of preparing an application and have not been notified by the Commissioner that they are not a tax charity.

Legislation

Income Tax Act 2007

Sections CW 41 and CW 42 are as follows.

CW 41 Charities: non-business income

Exempt income

(1) The following are exempt income:

(a) an amount of income derived by a trustee in trust for charitable purposes:

(b) an amount of income derived by a society or institution established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual.

Exclusion: trustees, society, or institution not registered

(2) This section does not apply to an amount of income if, at the time that the amount of income is derived, the trustee or trustees of the trust, the society, or the institution is not, or are not, a tax charity.

Exclusion: business income

(3) This section does not apply to an amount of income derived from a business carried on by, or for, or for the benefit of a trust, society, or institution of a kind referred to in subsection (1).

Exclusion: council-controlled organisation income

(4) This section does not apply to an amount of income derived by—

(a) a council-controlled organisation, other than a council-controlled organisation operating a hospital as a charitable activity:

(b) a local authority from a council-controlled organisation, other than from a council-controlled organisation operating a hospital as a charitable activity on behalf of the local authority.

Definition

(5) In this section and sections CW 42 and CW 43, tax charity means,—

(a) a trustee or trustees of a trust, a society, or an institution, registered as a charitable entity under the Charities Act 2005:

(b) a trustee or trustee of a trust, a society, or an institution (the entity), that––

(i) has started, before 1 July 2008, to take reasonable steps in the process of preparing an application for registering the entity as a charitable entity under the Charities Act 2005; and

(ii) intends to complete the process of preparing an application described in subparagraph (i); and

(iii) has not been notified by the Commissioner that the entity is not a tax charity:

(c) a trustee or trustee of a trust, a society, or an institution, that is or are non-resident and carrying out its or their charitable purposes outside New Zealand, and which is approved as a tax charity by the Commissioner in circumstances where registration as a charitable entity under the Charities Act 2005 is unavailable.

CW 42 Charities: business income

Exempt income

(1) Income derived directly or indirectly from a business carried on by, or for, or for the benefit of a trust, society, or institution of a kind referred to in section CW 41(1) is exempt income if—

(a) the trust, society, or institution carries out its charitable purposes in New Zealand; and

(b) the trustee or trustees of the trust, the society, or the institution is or are, at the time that the income is derived, a tax charity; and

(c) no person with some control over the business is able to direct or divert, to their own benefit or advantage, an amount derived from the business.

Subsections (3) to (8) expand on this subsection.

Exclusion

(2) This section does not apply to an amount of income derived by—

(a) a council-controlled organisation, other than a council-controlled organisation operating a hospital as a charitable activity;

(b) a local authority from a council-controlled organisation, other than from a council-controlled organisation operating a hospital as a charitable activity on behalf of the local authority.

Carrying on a business: trustee

(3) For the purposes of subsection (1), a trustee is treated as carrying on a business if—

(a) the trustee derives rents, fines, premiums, or other revenues from an asset of the trust; and

(b) the asset was disposed of to the trust by a person of a kind described in subsection (5)(b); and

(c) either—

(i) the person retains or reserves an interest in the asset; or

(ii) the asset will revert to the person.

Charitable purposes in New Zealand and overseas

(4) For the purposes of subsection (1)(a), if the charitable purposes of the trust, society, or institution are not limited to New Zealand, income derived from the business in a tax year is apportioned reasonably between those purposes in New Zealand and those outside New Zealand. Only the part apportioned to the New Zealand purposes is exempt income.

Control over business

(5) For the purposes of subsection (1)(b) for an income year, a person is treated as having some control over the business, and as being able to direct or divert amounts from the business to their own benefit or advantage if, in the tax year,—

(a) they are, in any way, whether directly or indirectly, able to determine, or materially influence the determination of,—

(i) the nature or extent of a relevant benefit or advantage; or

(ii) the circumstances in which a relevant benefit or advantage is, or is to be, given or received; and

(b) their ability to determine or influence the benefit or advantage arises because they are—

(i) a settlor or trustee of the trust by which the business is carried on; or

(ii) a shareholder or director of the company by which the business is carried on; or

(iii) a settlor or trustee of a trust that is a shareholder of the company by which the business is carried on; or

(iv) a person associated with a settlor, trustee, shareholder, or director referred to in any of subparagraphs (i) to (iii).

Control: settlor asset disposed of to trust

(6) For the purposes of subsection (5), a person is treated as a settlor of a trust, and as gaining a benefit or advantage in the carrying on of a business of the trust, if—

(a) they have disposed of an asset to the trust, and the asset is used by the trust in the carrying on of the business; and

(b) they retain or reserve an interest in the asset, or the asset will revert to them.

No control

(7) For the purposes of subsection (1)(b), a person is not treated as having some control over the business merely because—

(a) they provide professional services to the trust or company by which the business is carried on; and

(b) their ability to determine, or materially influence the determination of, the nature or extent of a relevant benefit or advantage arises because they—

(i) provide the services in the course of and as part of carrying on, as a business, a professional public practice; or

(ii) are a statutory trustee company; or

(iii) are Public Trust; or

(iv) are the Māori Trustee.

Benefit or advantage

(8) For the purposes of subsection (1)(b), a benefit or advantage to a person—

(a) may or may not be something that is convertible into money:

(b) unless excluded under paragraph (d), includes deriving an amount that would be income of the person under 1 or more of the following provisions:

(i) section CA 1(2) (Amounts that are income):

(ii) sections CB 1 to CB 23 (which relate to income from business or trade-like activities):

(iii) section CB 32 (Property obtained by theft):

(iv) sections CC 1 (Land), CC 3 to CC 8 (which relate to income from financial instruments), and CC 9 (Royalties):

(v) section CD 1 (Dividend):

(vi) sections CE 1 (Amounts derived in connection with employment) and CE 8 (Attributed income from personal services):

(vii) section CF 1 (Benefits, pensions, compensation, and government grants):

(viii) section CG 3 (Bad debt repayment):

(ix) sections CQ 1 (Attributed controlled foreign company income) and CQ 4 (Foreign investment fund income):

(c) includes retaining or reserving an interest in an asset in the case described in subsection (3), if the person has disposed of the asset to the trust or the asset will revert to them:

(d) does not include earning interest on money lent, if the interest is payable at no more than the current commercial rate, given the nature and term of the loan.

Non-exempt business income

(9) If an amount derived from the carrying on of a business by or for a trust is not exempt income because of a failure to comply with subsection (1)(b), the amount is trustee income.

Māori Trust Boards Act 1955

Section 24B of the Māori Trust Boards Act states:

24B. Trusts for charitable purposes

(1) Any Board may from time to time, in its discretion, execute under its seal a declaration of trust declaring that it shall stand possessed of any of its property, whether real or personal, upon trust for charitable purposes.

(2) Any income derived by the Board from any property to which the declaration relates shall be applied for such purposes referred to in section 24 or section 24A of this Act as may be specified in the declaration of trust; and, for the purposes of the Income Tax Act 2007, any such income shall be deemed to be income derived by trustees in trust for charitable purposes.

(3) No declaration of trust under this section shall have any force or effect unless it has been approved by the Commissioner of Inland Revenue.

Sections 24 and 24A specify the purposes for which a Māori Trust Board may apply money.

24. Functions of Board

(1) The functions of each Board shall be to administer its assets in accordance with the provisions of this Act for the general benefit of its beneficiaries, and, for that purpose, a Board may, in its discretion, provide money for the benefit or advancement in life of any specific beneficiary, or of any class or classes of beneficiaries.

(2) Without limiting the general provisions hereinbefore contained, it is hereby declared that each Board may, from time to time, subject to the provisions of this Act, apply money towards all or any of the following purposes:

(a) The promotion of health:

(i) By installing or making grants or loans towards the cost of installing water supplies, sanitation works, and drainage in Maori settlements;

(ii) By promoting, carrying out, or subsidising housing schemes, or by making grants or loans for any such schemes; or

(iii) By providing, subsidising, or making grants for medical, nursing, or dental services:

(b) The promotion of social and economic welfare:

(i) By making grants or loans for the relief of indigence or distress;

(ii) By developing, subsidising, or making grants or loans for farming or other industries;

(iii) By making grants or loans towards the cost of the construction, establishment, management, maintenance, repair, or improvement of Maori meeting houses, halls, churches, and church halls, villages, maraes, or cemeteries;

(iv) By establishing, maintaining, and equipping hostels for the purpose of providing either permanent or temporary accommodation;

(v) By making grants or loans towards the establishment of recreational centres for the common use of any Maori community and for such other uses as the Board thinks fit;

(vi) By promoting, carrying out, or subsidising roading schemes, power schemes, or such other schemes as the Board thinks fit, or by making grants or loans for any such schemes; or

(vii) By purchasing, acquiring, holding, selling, disposing of, or otherwise turning to account shares in any body corporate that has as one of its principal objects the economic or social advancement of Maoris, or the development of land:

(c) The promotion of education and vocational training:

(i) By assisting in the establishment of schools, and in the equipping, managing, and conducting of schools; by making grants of money, equipment, or material to schools or other educational or training institutions; or by making grants to funds

established or bodies formed for the promotion of the education of Māoris or for assisting Māoris to obtain training or practical experience necessary or desirable for any trade or occupation;

(ii) By providing scholarships, exhibitions, bursaries, or other methods of enabling individuals to secure the benefits of education or training, or by making grants to Education Boards or other educational bodies for scholarships, exhibitions, or bursaries;

(iii) By providing books, clothing, or other equipment for the holders of scholarships or other individuals, or by making grants for any such purpose; or by making grants generally for the purpose of assisting the parents or guardians of children to provide for their education or training for any employment or occupation;

(iv) By providing, maintaining, or contributing towards the cost of residential accommodation for children in relation to their education or training; or

(v) By the promotion of schemes to encourage the practice of Māori arts and crafts, the study of Māori lore and history, and the speaking of the Māori language:

(d) Such other or additional purposes as the Board from time to time determines.

(3) Nothing in this section shall be deemed to preclude any Board from applying money for the general benefit of a group or class of persons, notwithstanding that the group or class of persons includes persons other than beneficiaries; but no grant or loan shall be made to any individual for his exclusive benefit unless he is a beneficiary.

24A. Additional grants and payments by Boards

Any Board may from time to time, in its discretion—

(a) Make grants to the Māori Education Foundation established by the Māori Education Foundation Act 1961:

(b) Make payments, not exceeding in the aggregate the sum of $400 in any financial year, for any purposes not otherwise specifically authorised by this Act,—

whether or not any such grants or payments are of a direct or indirect benefit to the beneficiaries of the Board, or any of them.

Charities Act 2005

Section 13 of the Charities Act provides:

13. Essential requirements

(1) An entity qualifies for registration as a charitable entity if,—

(a) in the case of the trustees of a trust, the trust is of a kind in relation to which an amount of income is derived by the trustees in trust for charitable purposes; and

(b) in the case of a society or an institution, the society or institution—

(i) is established and maintained exclusively for charitable purposes; and

(ii) is not carried on for the private pecuniary profit of any individual; and

(c) the entity has a name that complies with section 15; and

(d) all of the officers of the entity are qualified to be officers of a charitable entity under section 16.

(2) The trustees of a trust must be treated as complying with subsection (1)(a) if,—

(a) in accordance with a ruling made under Part 5A of the Tax Administration Act 1994,—

(i) an amount of income derived by the trustees in trust is treated as having been derived by the trustees in trust for charitable purposes for the purposes of section CW 41 of the Income Tax Act 2007; or

(ii) income is treated as having been derived directly or indirectly from a business carried on by, or for, or for the benefit of the trustees in trust for charitable purposes for the purposes of section CW 42 of the Income Tax Act 2007; or

(b) the income derived by the trustees is deemed to be income derived by trustees in trust for charitable purposes under section 24B of the Maori Trust Boards Act 1955.

(3) A society or an institution must be treated as complying with subsection (1)(b) if, in accordance with a ruling made under Part 5A of the Tax Administration Act 1994, that society or institution is treated as being a society or institution that is established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual for the purposes of section CW 41 or section CW 42 of the Income Tax Act 2007.

(4) Subsections (2) and (3) cease to apply in relation to an entity if—

(a) the period for which the ruling applies has expired; or

(b) the ruling has ceased to apply because of section 91G of the Tax Administration Act 1994; or

(c) the ruling has otherwise ceased to apply to the entity.

(5) Despite subsections (1) to (3), an entity does not qualify for registration as a charitable entity if—

(a) the entity is a designated terrorist entity

as defined in section 4(1) of the Terrorism Suppression Act 2002; or

(b) the entity has been convicted of any offence under sections 6A to 13E of the Terrorism Suppression Act 2002.

Application of the legislation

Charitable purpose and public benefit tests

For a trust to be considered charitable for the purposes of the Income Tax Act, it must generally meet the common law requirements of charity. That is, a trust must be established for a "charitable purpose", and must meet what is known as the "public benefit test".

The term "charitable purpose" was defined in earlier Income Tax Acts as including:

> every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.

In 2003 the "charitable purpose" definition was extended by section OB 3B, which was inserted by section 76 of the Taxation (Māori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Act 2003 into the Income Tax Act 1994. Section OB 3B became section OB 3A in the Income Tax Act 2004. The Income Tax Act 2007 combined the "charitable purpose" definition with section OB 3A. Section YA 1 defines "charitable purpose" as including:

> every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community, and—
>
> (a) the purpose of a trust, society, or institution is charitable under this Act if the purpose would meet the public benefit requirement apart from the fact that the beneficiaries of the trust, or the members of the society or institution, are related by blood:
>
> (b) a marae has a charitable purpose if—
>
> (i) the physical structure of the marae is situated on land that is a Māori reservation referred to in Te Ture Whenua Māori Act 1993 (Māori Land Act 1993); and
>
> (ii) the funds of the marae are not used for a purpose other than the administration and maintenance of the land and of the physical structure of the marae, or not used for a purpose that is a charitable purpose other than under this paragraph.

The Court of Appeal noted in *Molloy v CIR* (1981) 5 NZTC 61,070; [1981] 1 NZLR 688 that the definition of charitable purpose in the Income Tax Act does not have the effect of enlarging or altering the ordinary, legal connotation of charity. This means that it is necessary to refer to general law to determine whether any specific taxpayer, or activity, is charitable. In *Commissioners of IT v Pemsel* [1891] AC 531, 583, Lord Macnaghten determined that all charitable purposes fall within four classes of charity (known as the "Pemsel Heads"), namely:

- the advancement of religion
- the relief of poverty
- the advancement of education
- any other matter beneficial to the community.

In addition to falling within one of the Pemsel Heads, with the exception of a trust for the relief of poverty, to be charitable in law a trust must be established for the benefit of the community or a sufficiently important class of the community, rather than for the benefit of private individuals. This requirement, which is in addition to the objects of the charity falling within one of the four heads listed above, is known as the public benefit test.

The public benefit test has been endorsed and further developed by a large body of case law, including *Verge v Somerville* [1924] All ER 121, *Oppenheim v Tobacco Securities Trust Co Ltd* [1951] 1 All ER 31, *Davies v Perpetual Trustee Co (Ltd)* [1959] 2 All ER 128 and *New Zealand Society of Accountants v CIR* [1986] 1 NZLR 148.

It is noted that the amended definition of "charitable purpose" now allows the purpose of a trust to be charitable if the purpose would meet the public benefit requirement apart from the fact that the beneficiaries of the trust are related by blood. The trust, however, must still satisfy other requirements of a charitable trust.

Section 24B of the Māori Trust Boards Act

Section 24B of the Māori Trust Boards Act was inserted into that Act by section 3 of the Māori Trust Boards Amendment Act 1962. Section 24B permits the establishment of charitable trusts by Māori Trust Boards, and provides a concessionary tax treatment of the income of such trusts.

There are two possible interpretations of the meaning of section 24B of the Māori Trust Boards Act:

- The first interpretation is that a declaration can be made under section 24B(1) only if the purposes of the trust are exclusively "charitable" within the common law meaning of the term. Although section 24B(2) requires that the income of the trust must be applied only for the purposes referred to in section 24 or section 24A, it follows from this approach that, as the trust must be also charitable, the income can be applied only for section 24 or section 24A purposes that are themselves charitable. Such income would, therefore, be exempt under the Income Tax Act.
- The second interpretation is that the income of a section 24B trust can be applied for any of the purposes

> referred to in section 24 or section 24A – whether those purposes are charitable under general law or not. This approach proceeds upon the basis that any income derived by the trust is deemed by section 24B(2), to the extent that it is applied for purposes specified in section 24 or section 24A, to be income derived in trust for charitable purposes for the purposes of the Income Tax Act, and therefore, exempt from income tax. This is irrespective of whether the purpose is a purpose that would generally be considered charitable in law.

The background papers relating to the introduction of section 24B, including Hansard, indicate that the new section was intended to remedy the concern, at the time, that trusts established by Māori Trust Boards were not considered charitable in terms of both the common law and the income tax legislation.

This view of the law was confirmed in *Arawa Maori Trust Board v Commissioner of Inland Revenue* (1961) 10 MCD 391. In that case Donne SM ruled that a trust established by the Arawa Māori Trust Board was not charitable for two reasons.

- Many of the purposes specified in section 24 of the Māori Trust Boards Act were not charitable purposes under the general law.
- The trust failed the public benefit test because it was for the benefit of a group of people determined by their bloodline or whakapapa. The Court determined that such a group of people did not satisfy the public benefit test.

Analysis

The Commissioner considers that the second interpretation, as set out above, and not the first interpretation, was what Parliament intended.

As has been noted, when section 24B was enacted, it was strongly argued, taking into account the decision in Arawa, that a trust that benefits a specific tribe or iwi, or the members of such a tribe or iwi, cannot be charitable at common law because it will not meet the requirements of the public benefit test. Therefore, it would be arguable that any trust established under section 24B could not be charitable, irrespective of the purposes for which it was established, because Māori Trust Boards are acknowledged by the Māori Trust Boards Act to be for the benefit of iwi and hapu determined on the basis of whakapapa.

This would give rise to a situation where, despite the enactment of section 24B, trusts established by Māori Trust Boards would possibly continue to be denied charitable status and the amendment would have no effective operation. Clearly, this cannot have been Parliament's intention.

Taking this into account, and after considering the available background documents, the Minister's statement (as recorded in Hansard) and the Commissioner's practice immediately following the enactment of section 24B, the Commissioner considers that the second interpretation is the correct view of the law.

Under the second interpretation, section 24B(1) allows a Māori Trust Board to declare that it holds property in trust for charitable purposes and authorises the Trust Board to settle some of the Trust Board's assets to a charitable trust.

Section 24B(2) has two limbs. The first limb states:

> Any income derived by the Board from any property to which the declaration relates shall be applied for such purposes referred to in section 24 or section 24A of this Act as may be specified in the declaration of trust;

The Commissioner considers that this limb limits the purposes for which the income of a charitable trust can be applied to those purposes that are referred to in sections 24 and 24A. The purposes for which the income is to be applied must be specified in the declaration of trust.

As previously noted, many of the purposes referred to in sections 24 and 24A may not be charitable purposes under common law. In addition, any trust established by a Māori Trust Board is allowed to apply its income only for the benefit of the Trust Board's beneficiaries, which are restricted, by the Māori Trust Boards Act, to the members of specified iwi. Such a requirement could mean that a trust would fail the public benefit test applied under the common law (although it is noted that due to the amended definition of "charitable purpose" as discussed above, since 2003 this would no longer be the case for the purposes of the tax Acts).

However, the second limb of section 24B(2) deems the income of the trust to be "income derived by trustees in trust for charitable purposes". The second limb states:

> and, for the purposes of the Income Tax Act 2007, any such income shall be deemed to be income derived by trustees in trust for charitable purposes.

Therefore, the effect of this section is to deem the income of the trust, even though it is established for purposes that may not be charitable in general law, to be "income derived by trustees in trust for charitable purposes" for the purposes of the Income Tax Act. This means that the requirements of sections CW 41 and CW 42, to the extent that those sections apply only to "income derived by trustees in trust for charitable purposes", have been satisfied. It is, therefore, not necessary for such a trust to satisfy the common law requirements of "charitable purpose" and the "public benefit test".

It should be noted that section 24B(2) of the Māori Trust Boards Act only modifies the requirements of the Income Tax Act. It does not apply for any other purposes.

Therefore, whatever may be the position of such a trust under common law and irrespective of whether the public benefit test would be met in other contexts, the Commissioner is satisfied that under this provision Parliament intended for a trust established under section 24B to be treated as a charitable trust for income tax purposes. The income of such a trust is, therefore, treated as having been derived for charitable purposes and as such is exempt from income tax under section CW 41 or CW 42.

Nevertheless, before that exemption can be applied, the requirements of section 24B(3) must be satisfied. That section requires a declaration of trust under section 24B(1) to be approved by the Commissioner before it will take effect. The Commissioner must still be satisfied that the constituting documents of the trust meet the legal requirements of a charitable trust. (In addition, from 1 July 2008 the trust must be registered with the Charities Commission, or the trust must have started the registration process before 1 July 2008 intending to complete it and have not been notified by the Commissioner that the trust is not a tax charity.)

Approval of charitable trust

As outlined above, section 24B(2) of the Māori Trust Boards Act modifies the general law requirements of a trust established under section 24B(1) to the extent that the trust is not required to satisfy the meaning of "charitable purpose" in section YA 1. However, before such a trust will be approved by the Commissioner under section 24B(3), the trust must still meet the other criteria of a charitable trust.

For example, the Commissioner must also be satisfied that the declaration of trust provides that:

- the charitable activities are restricted to New Zealand (if the trust is claiming exemption under section CW 42)
- the rules of the trust cannot be changed in order to allow the income of the trust to be applied to purposes that are not specified in section 24 or section 24A of the Māori Trust Boards Act, or to otherwise affect the charitable nature of the trust
- no person is able to derive a personal pecuniary profit from the trust
- trustees are unable to materially influence their remuneration
- professional services provided by trustees to the trust are provided at commercial rates and that conflicts of interest are avoided
- upon winding up, any remaining trust assets must be applied for charitable purposes.

This is not an exhaustive list of all matters that the Commissioner will consider when deciding whether a trust is charitable. (In addition, some of these requirements may be satisfied by compliance with the terms of the Māori Trust Boards Act.)

When a section 24B trust has previously obtained the Commissioner's approval, as required by section 24B(3) of the Māori Trust Boards Act, that approval will continue to apply and the trust is not required to apply annually for assessment of the liability to income tax. The approval given by the Commissioner under section 24B(3) will not be revoked, however, the trust must continue to apply its income for the purposes specified in the declaration in order to rely on the exemption.

Charities Act 2005

The Charities Act established the Charities Commission to set up and manage the Charities Register. The Charities Commission began receiving registrations from 1 February 2007. While registration is voluntary and non-registration does not mean that the entity is not charitable, there will be benefits to registration. One of the benefits of the registration process is that the charity will be entitled to exemptions from income tax under section CW 41 or CW 42. However, once registered, charities will still need to assess for themselves whether they continue to meet the requirements of the tax legislation to obtain a tax exemption. For further information see Operational Statement OS 06/02 *Interaction of tax and charities rules, covering tax exemption and donee status*.

The Charities Act amended sections CW 41 and CW 42 on 1 July 2008 so that only those charities that are registered or have begun the registration process with the Charities Commission are eligible for tax exempt status. For any entity wanting to continue receiving its current tax exemption or to begin to receive the tax benefits after 1 July 2008, that entity must have registered or have started the registration process with the Charities Commission by that date intending to complete it and have not been notified by the Commissioner that it is not a tax charity. This includes a trust established by a Māori Trust Board under section 24B of the Māori Trust Boards Act.

An entity will qualify for registration as a charitable entity if the essential requirements of section 13(1) of the Charities Act are met.

- The entity is established and maintained exclusively for charitable purposes.
- The entity is not for the private profit of any individual or group.

- The entity has a name that complies with the Charities Act.
- All the officers of the entity are qualified to be officers.

As discussed above, no declaration of trust shall have any force or effect unless it has been approved by the Commissioner under section 24B(3) of the Māori Trust Boards Act. Section 13(2)(b) of the Charities Act will treat such trusts as complying with the section 13(1)(a) requirement. Provided the trust can satisfy the other registration criteria, it will be registered with the Charities Commission. The trust will then be eligible for tax exemption under section CW 41 or section CW 42. However, continued tax exemption in respect of the income of the trust is dependent on the trust continuing to satisfy the other requirements of the Charities Act, including filing annual returns.

Where a Māori Trust Board has been dissolved

Some Māori Trust Boards have been dissolved (for example in the previous ruling it was mentioned that the Ngai Tahu Trust Board was dissolved by the Te Runanga o Ngai Tahu Act 1996). It was noted in the previous ruling that:

> notwithstanding the fact that the Trust Board has been dissolved and no longer exists, section 30(1)(c) provides that any income derived from property that was subject to the original declaration, to the extent that it is applied for the purposes specified in the declaration, shall be treated for tax purposes as being derived in trust for charitable purposes. This means that the income of the trust created under section 24B of the Māori Trust Boards Act will continue to be exempt for tax purposes.

Since the public ruling was last issued other runanga have been created. As indicated, this ruling relates only to trusts established under section 24B of the Māori Trust Boards Act. However, where a section 24B trust ceases to exist, the treatment of the income needs to be considered in the context of the Charities Act. Therefore, like any charitable entity, a runanga will need to register with the Charities Commission (or have started the registration process before 1 July 2008 intending to complete it and have not been notified it is not a tax charity) to continue to receive tax exemption status.

Period of Ruling

This ruling commences on the first day of the 2008/09 income year. The previous ruling expired on 31 March 2006. Given the terms of section 91C of the Tax Administration Act 1994, it is not possible to issue a ruling in respect of the Income Tax Act 2004 for the period beginning 1 April 2006 to the end of the 2007/08 income year. However, the Commissioner is of the view that the same principles and conclusions as set out in this ruling apply in respect of any income derived during this period from any property the subject of a declaration of trust under section 24B of the Māori Trust Boards Act.

Examples

Example 1

A Māori Trust Board executes a declaration of trust under section 24B of the Māori Trust Boards Act. The declaration provides that the trust will hold certain assets upon trust for charitable purposes. The declaration specifies that the income of the trust will be applied by making grants to reimburse any dental costs incurred by any of the beneficiaries, being members of the iwi.

The declaration is submitted to the Commissioner who is satisfied that the purpose for which the trust's income will be applied is a purpose specified in section 24 of the Māori Trust Boards Act (section 24(2)(a)(iii): "The promotion of health … by providing, subsidising, or making grants for medical, nursing, or dental services") and that there are adequate provisions in the trust deed to prevent the trust's income and assets from being used for other purposes.

The Commissioner will, therefore, approve the declaration under section 24B(3). The income of the trust will be eligible for exemption from income tax under section CW 41 or CW 42 if the trust is also registered with the Charities Commission. Provided the Māori Trust Board continues to apply its income for the purposes specified in its declaration of trust, being in compliance with the requirements in section 24 and section 24A of the Māori Trust Boards Act, the Income Tax Act and the Charities Act, the trust will be eligible to obtain a tax exemption under section CW 41 or CW 42.

Example 2

A Māori Trust Board makes a declaration under section 24B for the same purpose as described in Example 1. The Commissioner is satisfied that the purpose for which the trust's income is to be applied is a purpose that is specified in either section 24 or section 24A of the Māori Trust Boards Act.

However, it is found that the declaration does not prohibit the trustees from materially influencing the amount of remuneration that they receive. The declaration also does not provide for the disbursement of assets, upon winding up, to other charitable entities or purposes.

The Commissioner will, therefore, decline approval until such time as the declaration is amended in such a manner to satisfy the Commissioner's requirements.

GENERAL MATTERS

RESEARCH AND DEVELOPMENT TAX CREDIT – CONSULTATION AND AMENDMENTS TO ONLINE GUIDANCE MATERIAL

Updated material

Research and Development (R&D) tax credit online guidance material is being updated to reflect, among other things:

- matters raised during public consultation in early 2008
- issues emerging from discussions on R&D in agriculture.

The updated material will appear in October on our website at www.ird.govt.nz/rd-tax-credit/

The update will be identified on the R&D home page and a log of changes will be available in the additional information section.

IT and appreciable novelty consultation

Public consultation began in September on proposed changes and an addition to the R&D tax credit online guidance material in relation to:

- R&D in information technology
- additions to guidance on an appreciable element of novelty.

The consultation period runs until 18 November 2008. The consultation document is available on www.ird.govt.nz/public-consultation

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

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

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- ☐ Commissioner's comments
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