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TIB READER SURVEY

Many thanks to all the TIB readers who responded to the survey we included in the September/October issue of TIB. We're pleased to see that on the whole TIB's monthly contents are meeting your needs and we will be addressing your comments for improvements and changes in future issues. There is still time to respond to the survey if you would like to print off and complete the online version, available at **www.ird.govt.nz/aboutir/newsletters/tib/** and send it to Rachel Murrell, Inland Revenue, PO Box 2198, Wellington (freepost 154072) or fax it to 04 9781641.

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This *Tax Information Bulletin (TIB)* is also available on the internet in PDF. Our website is at **www.ird.govt.nz**

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

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

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

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 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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IN SUMMARY

Legislation and determinations

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Fair dividend rate method determination – Determination FDR 2008/13

The fair dividend rate method may be used for a type of attributing interest in a foreign investment fund (PIMCO Cayman Global Bond (NZD Hedged) Fund).

Foreign currency amounts – conversion to New Zealand dollars

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the six months ending 30 September 2008.

New legislation

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Climate Change Response (Emissions Trading) Amendment Act 2008

This Act amends the Climate Change Response Act 2002 to introduce a greenhouse gas emissions trading scheme in New Zealand. It also includes amendments to the Income Tax Act 2004, the Income Tax Act 2007 and the Goods and Services Tax Act 1985 to cover the income tax consequences to the forestry sector and the GST consequences to all sectors of transactions in emissions units.

Orders in Council

Mortgage diversion – KiwiSaver Amendment Regulations (No 2) 2008

This regulation came into effect on 16 October 2008 and clarifies which types of mortgages qualify for participation in the mortgage diversion facility whereby member contributions can be withdrawn from a KiwiSaver scheme and complying superannuation fund and applied towards amounts that are secured by a mortgage over a member's principal residence.

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

New Zealand's first tax information exchange agreement, concluded with the Netherlands on behalf of the Netherlands Antilles, entered into force on 2 October 2008.

Legal decisions – case notes

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Forfeiture of shares taxable under FIF regime – Govind Prasad Saha v CIR CIV 2007-485-701

The Commissioner treated the forfeiture of shares as a disposal at market value. The plaintiff maintained that the shares were not disposed of for gain; rather there was an adjustment to the original purchase price. His Honour held that the forfeiture operated as a purchase price adjustment; however, he did not consider that the arrangement mattered in terms of the FIF.

No deduction for fines – TRA 105/05 Dec 9/2008

The TRA accepted that there was no nexus to income earning and good policy reasons to disallow fines incurred by a trucking firm.

Judicial review granted for delay – Peter Allan Harris v the District Court at Auckland and CIR

The taxpayers were granted application for judicial review, holding that, considering the total time taken in the prosecution, there had been undue delay, and that in the circumstances, the District Court Judge should have exercised his inherent power to prevent an abuse of process and to direct a stay of the proceedings.

Test for intention/purpose – CIR v Boanas, Boanas, Railton and Railton (Mt Rosa Partnership)

The High Court clarified that the CIR did not need to look at the intentions of the individual partners but left it open for an individual partner to show a different intention or purpose from the other partners. The High Court also discussed the intention/purpose test.

TRA has jurisdiction to substitute an assessment – Beckham v CIR

The Taxation Review Authority has jurisdiction to substitute an available assessment where the original assessment of the Commissioner is not upheld.

LEGISLATION AND DETERMINATIONS

FAIR DIVIDEND RATE METHOD DETERMINATION

DETERMINATION FDR 2008/13 – USE OF FAIR DIVIDEND RATE METHOD FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND (PIMCO CAYMAN GLOBAL BOND (NZD HEDGED) FUND)

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Policy Manager, Inland Revenue under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Units in the non-resident issuer (PIMCO Cayman Global Bond (NZD Hedged) Fund) to which this determination applies, held by New Zealand resident investors, including TOWER Asset Management International Bond Fund, are an attributing interest in a foreign investment fund.

New Zealand resident investors are required to apply the foreign investment fund rules to determine their tax liability in respect of their units in the non-resident issuer each year.

As the non-resident issuer invests solely in financial arrangements and due to the presence of hedging arrangements that would be highly effective in terms of hedging the underlying foreign currency financial arrangements, section EX 46(10)(c) of the Act would apply to units in the non-resident issuer to prevent the use of the fair dividend rate (FDR) method in the absence of a determination made under section 91AAO of the Tax Administration Act 1994.

Despite the non-resident issuer having assets which 80% or more by value consist of financial arrangements effectively hedged to New Zealand dollars, I consider that it is appropriate for a New Zealand resident investor in this arrangement to use the FDR method. I would normally have concerns about using the FDR method for such investments. However, I consider that an investment in an actively traded debt portfolio can be more akin to equity than debt. This can be the case, for example, if the portfolio is designed to deliver above-normal but volatile returns from trading on market opportunities. If the investment proposition to the New Zealand resident investor is sufficiently in the ability of the fund manager, rather than only in the underlying debt assets themselves, then from a policy perspective it is appropriate for the FDR method to be used for the investment.

Scope of determination

This determination applies to units held by New Zealand resident investors, including TOWER Asset Management International Bond Fund, a portfolio investment entity, in a non-resident issuer.

1. The non-resident issuer:
   a) is a unit trust that is established in the Cayman Islands as a series trust of PIMCO Cayman Trust;
   b) is known as the PIMCO Cayman Global Bond (NZD-Hedged) Fund;
   c) issues New Zealand dollar denominated units (not being fixed rate shares, non-participating redeemable shares or guaranteed return shares) directly to the New Zealand investors;
   d) invests in a global bond portfolio using a trading strategy based on the benchmark index;
   e) actively manages the global bond portfolio;
   f) has a minimum turnover percentage target;
   g) seeks to hedge 95% to 105% of the value of the global bond portfolio to the New Zealand dollar;
   h) is managed against a global currency index and is permitted to have currency exposure to plus or minus 25% of the Fund's benchmark index on a per currency basis and is permitted to purchase currencies not represented in the index;
   i) has a target tracking error measured against the benchmark index.
2. TOWER Asset Management International Bond Fund will exercise no control or influence over the investment decisions of the non-resident issuer including the target minimum annual turnover percentage, asset allocation decisions and the target tracking error.

Interpretation

In this determination unless the context otherwise requires:

"Benchmark index" means the index that at the date of this determination is called the Lehman Brothers Global Aggregate Bond Index, or a replacement index with substantially the same features;

"PIMCO Cayman Trust" means a unit trust established in Cayman Islands pursuant to a declaration of trust;

"Series trust" means a separate and distinct unit trust established in the Cayman Islands as a series trust of PIMCO Cayman Trust;

"Fixed rate share" means a fixed rate share under section LL 9 of the Act;

"Non-participating redeemable share" means a non-participating share under section CD 22 of the Act;

"Guaranteed return share" means a share involving an obligation under section EX 46(10)(d) of the Act;

"The Act" means the Income Tax Act 2007;

"Minimum turnover percentage target" means the target percentage agreed with and disclosed before this determination is made to the Policy Manager, Inland Revenue who makes this determination;

"Target tracking error" means the target percentage agreed with and disclosed before this determination is made to the Policy Manager, Inland Revenue who makes this determination.

Determination

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

Application Date

This determination applies for the 2008–2009 and subsequent income years.

Dated at Wellington at this 16th day of September 2008.

David Carrigan
Policy Manager
Inland Revenue Department

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the six months ending 30 September 2008. These exchange rates are found in Table A.

Table B, which provides the exchange rates for the last day of the month, is no longer necessary for the CFC or FIF rules but we have provided it to assist taxpayers who may need exchange rates for those days.

You can choose either:

- the actual rate for the day for each transaction (including closing market value), or
- the average rate for the 12 months or the relevant period.

You must apply the chosen conversion method to all interests for which you use that FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note

An overseas currency converter is available in the "Work it out" section of our website.

This calculator can only be used where you have actual details for each month. The calculator cannot be used where details are only available on an annual total basis, in which case you will need to use the 12-monthly average rate in Table A (bottom row).

Table A – 12-month average

The non-shaded box is the average of the mid-month exchange rates for that month and the previous 11 months – that is the 12-month average. (Bottom row for each country)

Use this table to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the accounting profits, comparative value, fair dividend rate, deemed rate of return, or cost methods under sections EX 49(8), EX 51, EX 57 and EX 56 of the Income Tax Act 2007
- branch equivalent income or loss calculated under the CFC and FIF rules pursuant to section EX 21(4) of the Income Tax Act 2007 for accounting periods of 12 months
- foreign tax credits calculated under the branch equivalent method for a CFC or FIF under section LC 4(1B) of the Income Tax Act 2007 for accounting periods of 12 months

The shaded box in Table A is the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the next working day on which they were quoted. (Top row for each country)

You can use the mid-month rate if you have chosen to use actual rates for conversion. This mid-month rate is acceptable to Inland Revenue as equivalent to an actual rate for transactions occurring in that month.

You can also use the mid-month rate where a branch equivalent income or loss is calculated under the CFC or FIF rules pursuant to section EX 21(4) of the Income Tax Act 2007 where the accounting period is less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippines company (which is a FIF but does not produce a guaranteed yield) on 7 September 2008. The opening market value of the shares on 1 October 2008 or their closing market value on 30 September 2008 is PHP 350,000. Using the fair dividend rate the opening market value is converted as follows:

PHP 350,000 ÷ 31.1566 = $11,233.57

Example 2

A CFC resident in Hong Kong has an accounting period ending on 30 September 2008. Branch equivalent income for the period 1 October 2007 to 30 September 2008 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 5.2138 = $38,359.74

Example 3

A resident individual with a 31 March 2008 accounting period acquires a FIF interest in a Japanese company in January 2008 for 10,500,000 yen. The interest is sold in March 2008 for 10,000,000 yen. Using the comparative value method, these amounts are converted as:

JPY 10,500,000 ÷ 85.2042 = $123,239.22

JPY 10,000,000 ÷ 80.4491 = $124,302.19

Example 4

A CFC resident in Singapore was formed on 21 April 2008 and has a balance date of 30 September 2008. During the period 1 May 2008 to 30 September 2008, branch equivalent income of 500,000 Singaporean dollars was derived.

(i) Calculating the average monthly exchange rate for the complete months May–September 2008:

1.0541 + 1.0347 + 1.0167 + 0.9964 + 0.9572 = 5.0591 ÷ 5 = 1.0118

(ii) Conversion to New Zealand currency:

SGD 500,000 ÷ 1.0118 = $494,168.80

Table A Currency rates 2009 – mid month

Country	Currency	Code	15-Apr-08	15-May-08	15-Jun-08	15-Jul-08	15-Aug-08	15-Sep-08	15-Oct-08
			KEY: The exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the next day on which they were quoted. (Top row for each country; teal background)						
			The average of the mid-month exchange rates for that month and the previous 11 months. (Bottom row for each country; white background)						
Australia	Dollar	AUD	0.8526	0.8137	0.7993	0.7854	0.8144	0.8129	0.8885
			0.8728	0.8667	0.8586	0.8488	0.8440	0.8412	0.8437
Bahrain	Dollar	BHD	0.2972	0.2865	0.2828	0.2874	0.2660	0.2510	0.2331
			0.2885	0.2892	0.2892	0.2885	0.2878	0.2863	0.2814
Canada	Dollar	CAD	0.8035	0.7616	0.7728	0.7679	0.7480	0.7081	0.7205
			0.7847	0.7802	0.7778	0.7731	0.7708	0.7686	0.7658
China	Yuan	CNY	5.5207	5.3289	5.1936	5.2312	4.8494	4.5612	4.2399
			5.6701	5.6419	5.5978	5.5369	5.4822	5.4156	5.2833
Denmark	Krone	DKK	3.7164	3.6599	3.6348	3.5752	3.5799	3.4833	3.3809
			3.9929	3.9602	3.9137	3.8584	3.8242	3.7813	3.7236
European Community	Euro	EUR	0.4987	0.4911	0.4879	0.4797	0.4805	0.4656	0.4540
			0.5344	0.5300	0.5237	0.5161	0.5114	0.5075	0.4997
Fiji	Dollar	FJD	1.1944	1.1631	1.1521	1.1509	1.1328	1.0995	1.0722
			1.2082	1.2057	1.2007	1.1929	1.1892	1.1847	1.1733
French Polynesia	Franc	XPF	59.5488	58.6815	58.4675	57.6330	57.5038	55.8065	54.2786
			63.8816	63.3504	62.6053	61.7288	61.1695	60.7088	59.7850
Hong Kong	Dollar	HKD	6.1416	5.9215	5.8724	5.9589	5.5145	5.1976	4.8107
			5.9677	5.9811	5.9818	5.9659	5.9515	5.9303	5.8299
India	Rupee	INR	31.1686	31.9694	32.0203	32.5626	30.0314	30.2425	29.5426
			30.3557	30.5497	30.6970	30.7840	30.8400	30.9850	30.9408
Indonesia	Rupiah	IDR	7,248.5900	7073.4350	7005.7500	6993.9500	6487.1550	6290.6350	6048.5100
			7,046.5304	7094.9313	7111.4571	7102.3204	7076.3238	7042.9879	6961.2250
Japan	Yen	JPY	79.6408	79.7866	81.1073	81.0811	77.9651	70.5702	63.0743
			86.4867	85.7420	84.8171	83.5853	82.9504	81.9828	79.6431
Korea	Won	KOR	772.3700	796.9000	785.5550	766.8700	733.5500	738.0800	748.2400
			719.1463	728.7667	736.0913	739.8529	744.5383	750.8813	753.8825
Kuwait	Dollar	KWD	0.2092	0.2027	0.1994	0.2020	0.1896	0.1784	0.1654
			0.2131	0.2122	0.2108	0.2087	0.2074	0.2056	0.2013
Malaysia	Ringgit	MYR	2.4967	2.4883	2.4692	2.4718	2.3659	2.3055	2.1711
			2.5637	2.5617	2.5505	2.5302	2.5164	2.5013	2.4641
Norway	Krone	NOK	3.9528	3.8563	3.9229	3.8639	3.8277	3.8046	3.8776
			4.2416	4.1917	4.1382	4.0843	4.0463	4.0290	4.0023
Pakistan	Rupee	PKR	49.6068	51.5631	49.7165	52.8920	52.5463	50.6476	48.8520
			46.8186	47.4132	47.7867	48.2458	48.9792	49.6186	49.7950
Papua New Guinea	Kina	PGK	2.1433	2.0247	1.9907	1.9767	1.8289	1.7033	1.5756
			2.1699	2.1575	2.1389	2.1073	2.0822	2.0526	1.9990
Philippines	Peso	PHP	32.6099	32.3167	33.1934	34.2927	31.7734	30.9413	29.0903
			33.1102	32.9366	32.8125	32.6814	32.5679	32.4174	32.0421
Singapore	Dollar	SGD	1.0683	1.0454	1.0347	1.0319	0.9998	0.9540	0.9066
			1.1180	1.1122	1.1022	1.0890	1.0799	1.0697	1.0508
Solomon Islands	Dollar	SBD	5.9335	5.8003	5.7522	5.8488	5.4053	5.1020	4.7455
			5.6146	5.6512	5.6767	5.6912	5.7042	5.6926	5.6203
South Africa	Rand	ZAR	6.1946	5.7972	6.0856	5.8459	5.5478	5.3816	5.6271
			5.4915	5.5493	5.6079	5.6391	5.6574	5.6810	5.7143
Sri Lanka	Rupee	LKR	84.5827	81.4159	80.6769	81.9635	75.7057	71.6020	66.7265
			84.1051	84.0989	83.9117	83.4448	82.9999	82.2804	80.5368
Sweden	Krona	SEK	4.6866	4.5680	4.5624	4.5473	4.4929	4.4349	4.4339
			4.9699	4.9330	4.8709	4.8148	4.7720	4.7453	4.7001
Switzerland	Franc	CHF	0.7891	0.8012	0.7864	0.7757	0.7735	0.7498	0.7029
			0.8748	0.8666	0.8543	0.8401	0.8312	0.8228	0.8048
Taiwan	Dollar	TAI	23.9000	27.1550	26.5450	23.2350	22.1450	21.2950	20.1050
			24.7404	24.9558	25.0983	24.8829	24.7317	24.5396	24.1083
Thailand	Baht	THB	24.6873	24.3229	24.6809	25.5125	23.6032	22.7918	20.9609
			23.9504	23.9494	23.9971	24.1381	24.1930	24.2077	23.9365
Tonga	Pa'anga	TOP	1.4209	1.3644	1.3502	1.3770	1.3193	1.2893	1.3045
			1.4459	1.4396	1.4304	1.4210	1.4136	1.4025	1.3859
United Kingdom	Pound	GBP	0.3989	0.3903	0.3853	0.3828	0.3787	0.3701	0.3555
			0.3830	0.3845	0.3849	0.3845	0.3858	0.3870	0.3849
United States	Dollar	USD	0.7885	0.7596	0.7517	0.7639	0.7060	0.6670	0.6203
			0.7685	0.7703	0.7704	0.7685	0.7667	0.7629	0.7482
Vanuatu	Vatu	VUV	73.9818	71.3191	70.5083	71.7440	69.2301	69.8334	67.8085
			74.0462	73.7543	73.2808	72.7604	72.6286	72.6030	72.0965
Western Samoa	Tala	WST	1.9072	1.8711	1.8463	1.8781	1.7689	1.7946	1.6879
			1.9130	1.9119	1.9056	1.8965	1.8911	1.8852	1.8635

How to use this table

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. ◊◊ If you are using the mid-month rate (ie not the average for the last 12 months) then you can use our online currency converter and have the income and tax deductions converted for you. ◊◊ If you need an exchange rate for a country or a day not listed in these tables, contact one of New Zealand's major trading banks. Round the exchange rate calculations to four decimal places wherever possible.

Table B Currency rates 2009 – End of month

Table B lists the end-of-month exchange rates acceptable to us for the six-month period ended 30 September 2008. They are provided simply as a service but are not relevant for the CFC or FIF rules.

Country	Currency	Code	30-Apr-08	31-May-08	30-Jun-08	31-Jul-08	31-Aug-08	30-Sep-08
Australia	Dollar	AUD	0.8292	0.8144	0.7912	0.7770	0.8135	0.8361
Bahrain	Dollar	BHD	0.2917	0.2933	0.2868	0.2763	0.2640	0.2525
Canada	Dollar	CAD	0.7840	0.7696	0.7689	0.7505	0.7375	0.7010
China	Yuan	CNY	5.4139	5.4021	5.2224	5.0113	4.7891	4.6165
Denmark	Krone	DKK	3.7099	3.7399	3.5906	3.5100	3.5550	3.4685
European Community	Euro	EUR	0.4977	0.5018	0.4819	0.4708	0.4767	0.4654
Fiji	Dollar	FJD	1.1813	1.1735	1.1546	1.1247	1.1252	1.0928
French Polynesia	Franc	XPF	59.5514	59.2887	58.0894	56.9809	57.2846	55.7870
Hong Kong	Dollar	HKD	6.0893	5.9976	5.9032	5.8403	5.4940	5.2138
India	Rupee	INR	31.0838	32.4468	32.1802	31.6983	30.2584	30.6742
Indonesia	Rupiah	IDR	7228.2350	7161.3175	7009.6375	6845.5400	6450.2150	6325.2900
Japan	Yen	JPY	80.1741	80.9513	76.2565	80.1639	77.3708	70.3834
Korea	Won	KOR	778.1300	799.6225	789.6625	755.6875	745.9000	768.6175
Kuwait	Dollar	KWD	0.2076	0.2043	0.2004	0.1984	0.1885	0.1789
Malaysia	Ringgit	MYR	2.4844	2.5119	2.4776	2.4349	2.3720	2.3165
Norway	Krone	NOK	3.9676	3.9067	3.8851	3.8216	3.8002	3.8382
Pakistan	Rupee	PKR	49.4873	51.7219	50.5604	52.3932	52.5033	51.4203
Papua New Guinea	Kina	PGK	2.1232	2.0603	1.9880	1.9319	1.8140	1.7061
Philippines	Peso	PHP	32.5483	33.1255	33.5303	33.2819	31.7859	31.1566
Singapore	Dollar	SGD	1.0611	1.0541	1.0347	1.0167	0.9964	0.9572
Solomon Islands	Dollar	SBD	5.9241	5.8750	5.7821	5.7375	5.3896	5.1270
South Africa	Rand	ZAR	6.0390	5.8441	6.0464	5.6287	5.4785	5.4886
Sri Lanka	Rupee	LKR	83.9713	82.4720	81.1160	80.2237	75.5070	72.0615
Sweden	Krona	SEK	4.6738	4.6202	4.5499	4.4952	4.4915	4.4839
Switzerland	Franc	CHF	0.7971	0.8091	0.7806	0.7724	0.7720	0.7408
Taiwan	Dollar	TAI	23.8475	25.4325	24.8325	22.8150	22.1400	21.4575
Thailand	Baht	THB	24.5573	24.6974	24.9875	24.9481	23.6726	22.7531
Tonga	Pa'anga	TOP	1.4154	1.3760	1.3586	1.3461	1.3095	1.3041
United Kingdom	Pound	GBP	0.3962	0.3921	0.3833	0.3952	0.3808	0.3708
United States	Dollar	USD	0.7820	0.7691	0.7582	0.7487	0.7037	0.6704
Vanuatu	Vatu	VUV	73.5547	72.1113	70.9596	70.5461	69.1774	68.9111
Western Samoa	Tala	WST	1.9089	1.8829	1.8518	1.8430	1.7884	1.7919

How to use this table

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. ◊◊ If you need an exchange rate for a country or a day not listed in these tables, contact one of New Zealand's major trading banks. ◊◊ Round your exchange rate calculations to four decimal places wherever possible.

NEW LEGISLATION

CLIMATE CHANGE RESPONSE (EMISSIONS TRADING) AMENDMENT ACT 2008

The Climate Change Response (Emissions Trading) Amendment Act 2008 (Climate Change Act) has the principal purpose of amending the Climate Change Response Act 2002 to introduce a greenhouse gas emissions trading scheme in New Zealand. However, the Climate Change Act also includes amendments to the Income Tax Act 2004, the Income Tax Act 2007, and the Goods and Services Tax Act 1985 (GST Act) to cover the income tax consequences to the forestry sector and the GST consequences to all sectors of transactions in emissions units. These amendments are the subject of this article.

Sections CB 29, CW 3B, CX 44F, DB 46, DB 47, EB 2(3)(h), ED 1(5B), EW 5(3B), GD 16 and OB 1 of the Income Tax Act 2004

Sections CB 36, CW 3B, CX 48B, DB 60, DB 61, EB 2(3)(i), ED 1(8B), EW 5(3B), GC 4B and YA 1 of the Income Tax Act 2007

Sections 2(1), 11(1)(n), 11A(1)(s), (t), (u) and (v) of the Goods and Services Tax Act 1985

Background

The Climate Change (Emissions Trading and Renewable Preference) Bill was introduced into Parliament on 4 December 2007. It received its first reading on 11 December 2007 and its second reading on 28 August 2008. The provisions dealing with amendments to the GST Act were introduced by Supplementary Order Paper 231 at the Committee stage of proceedings. The resulting Climate Change Response (Emissions Trading) Amendment Act 2008 and the Electricity (Renewable Preference) Amendment Act 2008 received Royal assent on 25 September 2008.

The Climate Change Act amends the Climate Change Response Act 2002, inserting provisions under which:

- businesses in certain sectors will be required to surrender emissions units based on their actual emissions, or emissions treated as being made as a consequence of their activities
- the government may allocate emissions units to businesses in certain sectors.

Amendments to income tax legislation are required to ensure that the income tax treatment of emissions units is clear, and that income and expenditure are recognised for income tax purposes in a way which is consistent with the objectives of the emissions trading scheme and the income tax system.

Amendments to GST legislation have been made to ensure that GST compliance impacts are minimised and to facilitate the trading of emissions units on international markets.

Key features

Income tax legislation has been amended to provide for the tax consequences of transactions in emissions units related to forestry businesses. The main features of the changes are:

- emissions units are ordinarily treated as being on revenue account
- emissions units are treated as excepted financial arrangements, so are valued using a cost basis methodology
- the cash basis of taxation, which generally applies to transactions entered into by forestry businesses, also applies to emissions unit transactions entered into by forestry businesses
- while the ordinary rule of revenue account treatment applies to transactions relating to post-1989 forest land, emissions units transactions relating to pre-1990 forest land are an exception from the general rule and are generally treated as being on capital account
- transactions relating to emissions units are zero-rated for GST purposes.

The legislative changes apply only to emissions units which are New Zealand units, Kyoto units and units issued by overseas registries that can be transferred into an account in the New Zealand registry. They do not apply to voluntary or "unofficial" emissions units, which remain subject to ordinary income tax and GST rules.

Application date

The income tax changes apply from 26 September 2008. The GST changes apply from 1 January 2009.

Detailed analysis

Income tax valuation methodology

The legislation treats emissions units as excepted financial arrangements. Accordingly, either the first-in first-out (FIFO) or weighted average cost valuation methods apply. There is no requirement to revalue emissions units if their market changes.

Income tax treatment of emissions unit transactions relating to post-1989 forestry

Emissions unit transactions relating to post-1989 forest land follow ordinary principles and are treated as being on revenue account. While the underlying concepts are that the acquisition of emissions units is deductible, and their disposal is assessable, the application of the cash basis of taxation, and detailed timing and matching rules mean that each transaction must be considered against the applicable legislation.

The treatment of each common transaction is as follows (statutory references are to the Income Tax Act 2007):

- no taxable income arises on the allocation of units to the forestry business by the government (CX 48B)
- a tax liability arises on the sale of government-allocated units. The taxable amount will be the entire proceeds of the sale, because these units have no direct costs (indirect costs have already been deducted) (CB 36(2))
- where units are purchased to replace units previously sold ("replacement ETS units"), an income tax deduction is available (DB 60(3) and ED 1(8B))
- where "additional" units are purchased, no income tax deduction will be available if those units are still held at the end of the tax year (ED 1)
- no income tax deduction arises when a deforestation liability arises (principles of cash basis taxation method).
- no income tax deduction arises when government-allocated units are surrendered (ED 1)
- no income tax deduction arises when replacement ETS units are surrendered (the deduction was already given on their purchase) (CB 36(3) and ED 1(8B))
- an income tax deduction is available when additional units purchased are surrendered (CB 36(3) and ED 1).

Example – post-1989 forest land

1 April 2009 – ABC Forestry Ltd is awarded 100 emissions units for carbon capture in its post-1989 forest. The market value of the units is $30 each.

No tax consequences arise.

30 June 2009 – ABC sells 10 units for $35 each.

ABC is taxable on $350 in the year of sale. No deduction is given against the sale proceeds as there is no cost base.

15 August 2009 – ABC purchases 20 units for $32 each.

An income tax deduction in the year of purchase is available for 10 of these units, which can be treated as "replacement ETS units". No income tax deduction is available for the 10 "additional" units, which sit in ABC's books at year end at their cost of $320 – the deduction for the additional units arises when the units are surrendered or disposed of.

30 November 2009 – ABC harvests the forest.

No tax consequences arise.

30 April 2010 – ABC transfers 100 units to the government to discharge its harvest liability to surrender units.

No tax consequences arise.

5 May 2010 – ABC sells the remaining 10 units for $38 each.

ABC has net income of ($38-$32) × 10 = $60, arising in the year of sale.

(Example assumes FIFO valuation method applied).

Income tax treatment of emissions unit transactions relating to pre-1990 forestry

Emissions unit transactions relating to pre-1990 forestry are generally treated as being on capital account, which means that no income tax liabilities arise from, and no income tax deductions are created by, these transactions. Specifically:

- no taxable income arises on the receipt of "free" units from the government (CW 3B(2))
- no taxable income arises if any of those "free" units are sold (CW 3B(3))
- no income tax deduction arises if additional units are purchased to satisfy a deforestation liability, or where units are purchased in excess of any potential liability and remain held at the end of the year (ED 1)

- no income tax deduction arises when a deforestation liability arises (principles of cash basis taxation method)
- no income tax deduction arises when units are surrendered to the government to meet a deforestation liability (CB 36(5)).

The capital account treatment applies only to transactions in emissions units which are related to pre-1990 forestry land. If a business which owns pre-1990 forest land purchases emissions units and later sells them, any gain will be taxable and any loss will be deductible, as they would be for a business which did not own pre-1990 forest land (CB 36(2)).

There is an exception to capital account treatment. Certain businesses, such as property developers and land traders, will hold pre-1990 forest land on revenue account. Emissions unit transactions carried out by such businesses in relation to pre-1990 forest land will be on revenue account. Their treatment will generally be the same as transactions relating to post-1989 forest land, described above (CB 36(4)(b) and CW 3B(3)).

Example – pre-1990 forest land

1 April 2009 – The government allocates DE Forestry Ltd 100 emissions units in relation to pre-1990 forest land that it owns. The market value of the units is $30 each.

No tax consequences arise.

30 June 2009 – DEF sells 10 units for $35 each.

No tax consequences arise.

15 August 2009 – DEF purchases 1,410 units for $32 each.

No tax consequences arise.

30 November 2009 – DEF fells forest and converts land to dairy farm.

No tax consequences arise.

30 April 2010 – DEF transfers 1,000 emissions units to the government to discharge deforestation liability.

No tax consequences arise.

5 May 2010 – DEF sells remaining 500 emissions units for $35.

DEF is taxable on ($35–$32) × 500 = $1,500.

(Example assumes FIFO valuation method applied).

GST treatment of emissions unit transactions

The supply of emissions units (other than "unofficial" emissions units) is zero-rated. Under zero-rating, emissions units are treated as being subject to GST for the purposes of measuring taxable supplies made by businesses. However, the amount of GST actually charged and so the GST to be accounted for by both transferor and transferee is nil.

Transactions that are supplies of emissions units and that are zero-rated include (section references are to the GST Act):

- the allocation of emissions units by the government to a business (11A(1)(s))
- the surrender of emissions units by a business to the government (11A(1)(t))
- the sale of emissions units by a business, whether to a buyer in New Zealand or overseas (11A(1)(v))
- the purchase of emissions units by a business from the government (11A(1)(v))
- the purchase of emissions units by a business from another business, whether the selling business is in New Zealand or is overseas (11A(1)(v)).

When emissions units are awarded by the government to a business, without a cash payment being made by the business, any actual supply which the business makes in exchange for those units, or is deemed to make in accordance with the GST Act, will also be zero-rated (11A(1)(u)).

When the transaction is one where an express monetary price has been agreed for the units, then the value of that supply will be the price agreed for the units.

When the transaction is one where the government supplies emissions units, and an actual or deemed supply is made in exchange for that supply of emissions units, the value of both supplies is the market value of the emissions units.

Example – GST

1 April 2009 – ABC Forestry Ltd is awarded 100 emissions units for carbon capture in its post-1989 forest. The market value of the units is $30 each.

The government makes a taxable supply of emissions units valued at $3,000 to ABC. ABC makes a supply of services to the government valued at $3,000. Both supplies are zero-rated so no input tax or output tax arises for either party on either transaction.

30 June 2009 – ABC sells 10 units for $35 each.

ABC makes a taxable supply of $350. The supply is zero-rated so no output tax is payable by ABC and the purchaser cannot claim any input tax.

15 August 2009 – ABC purchases 20 units for $32 each.

ABC receives a taxable supply of $640, but the supply is zero-rated so no input tax can be claimed.

30 April 2010 – ABC transfers 100 units to the government to discharge the liability to surrender emissions units which arose on harvesting the forest in November 2009.

ABC makes a taxable supply of emissions units, but it is zero-rated and so no output tax is payable.

ORDERS IN COUNCIL

Mortgage diversion

KiwiSaver Amendment Regulations (No 2) 2008

The mortgage diversion regulations provide a facility that allows member contributions[1] to be withdrawn from a KiwiSaver scheme and complying superannuation fund and applied towards amounts that are secured by a mortgage over a member's principal residence, if the provider and the mortgagee (bank) choose to participate.

The KiwiSaver Amendment Regulations (No 2) 2008 amend regulation 23 governing which types of mortgages qualify for participation in the mortgage diversion facility. The measure was approved by Order in Council signed on 15 September 2008, with effect from 16 October 2008.

The intent of the regulations is to ensure that a mortgage over a member's principal residence is eligible, provided that the mortgage secures amounts (including principal interest and other amounts) used or acquired in connection with the member's principal residence (defined as a home loan facility) regardless of whether the mortgage also secures other obligations. This recognises that most mortgages are "all obligations" in nature, and they secure many different loan types or credit facilities, and that it will not be practical to restrict eligibility to those mortgages that secure only advances used in connection with a member's principal residence.

This is achieved by stipulating two conditions which must be complied with at all times in order to qualify for mortgage diversion:[2]

- Contributions diverted from the member's KiwiSaver scheme may be applied only to the payment of amounts (including principal, interest, or any other amounts payable) that are owing under the home loan facility secured by the qualifying mortgage (subclause 2).
- If contributions are diverted to a home loan facility, the member must not be able , without making a specific application to the mortgagee (bank), to access, withdraw, or redraw (as applicable) the amount of any diverted contributions (in whole or in part).

The policy rationale for the words "without making a specific application to the mortgagee (bank)" is to prevent members having an automated ability to withdraw diverted contributions because the purpose of mortgage diversion is to help reduce debt. Therefore, some positive action on the part of a bank employee needs to occur in order to comply with this requirement. If the bank cannot comply with this condition the mortgage securing the loans does not qualify.

This condition strikes a balance between acknowledging that re-financing through the use of a mortgage cannot be realistically prevented, and ensuring that members cannot immediately access diverted contributions.

[1] A member may divert up to half of the total contribution.

[2] This is in addition to the mortgage being over the principal residence and that it secures obligations arising under a home loan facility, whether or not the mortgage also secures other obligations (see regulation 23(1).

Example 1

John's mortgage secures an instalment (table) loan, an interest only loan, and a non-reducing revolving credit facility with his Bank.

John's mortgage will qualify, provided that:

- the mortgage is over his principal residence
- the mortgage secures obligations that arise under the home loan facility
- the table loan and interest only loan are primarily used or acquired for purposes in connection with the member's principal residence
- the diverted contributions are applied to the payment of amounts that are owing under the table loan and interest only loan secured by the mortgage
- John cannot, without making a specific application to the bank, access, withdraw, or redraw the diverted contributions.

The instalment (table) loan and interest only loan satisfy the definition of "home loan facility". The contributions cannot be diverted to the 10% non-reducing revolving credit loan because this type of loan is specifically excluded from the definition of home loan facility.

Example 2

Laura's mortgage is a variable rate mortgage and her bank allows her to re-draw amounts that she has paid over the minimum payment stipulated by her repayment schedule. Laura's mortgage will qualify, provided that:

- the mortgage is over her principal residence
- the mortgage secures obligations that arise under the home loan facility
- the variable rate home loan was primarily used or acquired for purposes in connection with her principal residence. If Laura's variable rate home loan was used to finance the purchase of an investment property, or to finance a business, then the mortgage will not qualify
- Laura's diverted contributions are applied toward the payment of amounts owing under the variable rate home loan secured by the mortgage
- Laura's bank can ensure she cannot, without making a specific application to the bank, access the diverted contributions.

Example 3

Amelia has a reducing limit revolving credit facility, where she can repay and draw down funds up to a set limit, but that limit reduces on a regular basis. Amelia's mortgage will qualify, provided that:

- the mortgage is over her principal residence
- the mortgage secures obligations that arise under the home loan facility
- the reducing limit revolving credit facility was primarily used or acquired for purposes in connection with Amelia's principal residence
- the diverted contributions are applied to the payment of amounts that are owing under the reducing revolving credit facility
- Amelia cannot, without making a specific application to the bank, access, withdraw or redraw the diverted amount.

NEW TAX INFORMATION EXCHANGE AGREEMENT WITH THE NETHERLANDS ON BEHALF OF THE NETHERLANDS ANTILLES

New Zealand's first tax information exchange agreement, concluded with the Netherlands on behalf of the Netherlands Antilles, has entered into force.

Tax information exchange agreements are bilateral international treaties that enable tax authorities to exchange information on tax matters in order to assist each other in the detection and prevention of tax avoidance and evasion. The information that may be exchanged includes tax records, business books and accounts, bank information and ownership information.

Exchange of information arrangements already feature in the 35 double tax agreements to which New Zealand is party. However, the agreement establishing information exchange with the Netherlands Antilles is the first of a number of arrangements that New Zealand is seeking to establish outside of its double tax agreement network.

The agreement was signed on 1 March 2007 and incorporated into New Zealand law by Order in Council on 1 September 2008. The agreement entered into force on 2 October 2008 and will have effect from 1 January 2009.

The text of the tax information exchange agreement is published at **www.taxpolicy.ird.govt.nz**

LEGAL DECISIONS – CASE NOTES

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

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

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

FORFEITURE OF SHARES TAXABLE UNDER FIF REGIME

Case	Govind Prasad Saha v CIR CIV 2007-485-701
Decision date	23 September 2008
Act	Income Tax Act 1994, FIF rules
Keywords	Comparative value method, disposal, forfeiture, FIF, shares

Summary

The Commissioner treated the forfeiture of shares as a disposal at market value. The plaintiff maintained that the shares were not disposed of for gain; rather there was an adjustment to the original purchase price. His Honour held that the forfeiture operated as a purchase price adjustment; however, he did not consider that the arrangement mattered in terms of the Foreign Investment Fund Rules (FIF).

Facts

In 2000, Ernst and Young (E&Y) sold the consultancy arm of its business to Cap Gemini, an international company. After a parent agreement was reached, the partners of E&Y in each country where the business offered the consultancy service in issue had the option of joining the sale. The New Zealand office chose to do so. The sale involved the transfer of the relevant E&Y staff to the new business. Those staff members entered into employment agreements with the new company. In the case of partners such as the plaintiff, the agreements included a penalty formula if the partner left the new company within the term of the five-year employment agreement. The penalty formula involved the return of some shares which the partner had received as his or her share of the sale proceeds. It was a sliding scale formula where the amount liable to be returned decreased as the years went by. Rules were also put in place to prevent diminution of the share holdings during the five-year period. The plaintiff left the new company within the five-year term of his contract, and the sliding scale formula was applied. This meant he forfeited a number of shares he had received.

The share allocations and disposals were caught by the Foreign Investment Fund Rules (FIF). The FIF rules are designed to operate by attributing a pro-rata share of the foreign identity's income to the taxpayer. The value of the taxpayer's share in the FIF may be assessed by one of four methods – accounting profits, branch equivalent, comparative method and deemed rate of return.

The plaintiff elected to use the comparative value method in section CG 18 of the Income Tax Act 1994 as the route to which his interest was to be valued. Under this method, if the value of a person's holding has increased during the course of a tax year, that increase will be treated as income, and if it has decreased it will be treated as a deductible loss.

During the 2002 year, the plaintiff forfeited 2095 shares as he had left the employment of Cap Gemini. The Commissioner and the plaintiff disagreed as to the treatment of these shares in the CG 18 formula. The Commissioner treated the forfeiture of shares as a disposal of an interest in a fund which is deemed by section CG23(5) to be at market value. The plaintiff maintained that the shares were not disposed of for gain; rather there was an adjustment to the original purchase price reflecting that what the plaintiff had sold to Cap Gemini in 2001 had become less valuable. The plaintiff further argued that if it was too late to visit the 2001 assessment, then each income tax year should be treated separately.

Decision

Simon France J set out the provisions of CG 23(5), regarding them as the crux of this dispute:

> For the purposes of this Act, where at any time in an income year a Person disposes of any property which is, with respect to the period immediately before disposition, an interest of the person in a fund with respect to which the person uses the comparative value method or the deemed rate of return method, **for no consideration or for consideration which is less than the market value of the property at the time, the person shall be deemed to have derived from the disposition consideration equal to the market value of the property at the time.**

His Honour held that the forfeiture operates as a purchase price adjustment. However he did not consider that the arrangement mattered in terms of the FIF rules; and stated:

> [50] In tax year 2001 Dr Saha declared his interest in a foreign investment fund to be 7566 shares, such shares having been acquired by him at a cost of $3,497,552. For tax purposes, Dr Saha therefore had that degree of interest in the foreign company. Thereafter, any adjustments in the number of shares had to be reflected in the relevant tax year. Acquisition of further shares would be treated as a deductible cost but of course, the year end value would also reflect the greater number of shares. Disposition of shares would be treated as an assessable gain, but again the year end value would reflect the lesser number of shares now owned.

His Honour considered that there was no consideration for the disposal and it was therefore deemed by section CG23 (5) to amount to a disposal at market value:

> [51] In tax year 2002 Cap Gemini has not paid anything for the shares. No consideration at the time of the disposal has passed from Cap Gemini to Dr Saha. Rather, it is, as the taxpayer contended, an adjustment to the original purchase price. Accordingly, I would see CG23 (5) as directly engaged, as the Commissioner contends.

NO DEDUCTION FOR FINES

Case	TRA 105/05 Dec 9/2008
Decision date	17 September 2008
Act	Income Tax Act 1994
Keywords	Fines, deductibility

Summary

The TRA accepted that there was no nexus to income earning and good policy reasons to disallow fines incurred by a trucking firm.

Facts

The taxpayer is a trucking firm which transported timber from forests for processing. In the course of this activity the firm had received fines for overloading its trucks. The firm sought to deduct these fines in the 2000 to 2002 income years inclusive.

A good deal of expert evidence regarding the loading and weighing of trucks was adduced by both sides. The taxpayer argued that while they did not accept the fines could not be successfully challenged in court (on the basis of various statutory defences including a "no fault" defence) it was simply better business to pay the fine than to challenge it [par 6]. The Commissioner took the view that the taxpayer had failed to take reasonable steps to avoid the fines [par 42]. Noting that the relevant legislation "built in" a five percent tolerance before a truck driver would be fined the Commissioner submitted that the taxpayer was "cavalier" in its attitude [paragraphs 49 and 57-58].

Decision

Barber DCJ concluded that the fines were not deductible.

His Honour reviewed the case law in the area identifying that in major Commonwealth countries (Australia, England and New Zealand) fines were not usually deductible (paragraphs [71] to [104]). He noted the Canadian case law to the opposite effect was overridden by statute to prohibit the deductibility of fines and penalties (par [107].

Despite observing that New Zealand cases were “not clear” upon the issue of whether or not fines and penalties had sufficient nexus to be deductible, his Honour continued:

[109] However, it seems to me that a business should operate within the law. The disputant’s business of carting logs on large trucks and trailers is able to comply with the law, but there is expense involved in weight-of-load compliance and such non-compliance can involve a relatively modest amount of annual fines. It seems to me to be illogical to seek to deduct fines relating to a breach of the law as if they were a business expense, because they relate to activities which do not conform to the law and so are not within the permitted scope of the business. I consider that a penalty/fine arising from a taxpayer’s illegal activities (ie, transporting too-heavy a load) cannot have a sufficient nexus with the taxpayer’s income earning process so as to create deductibility for that cost of the fine.

He also noted that he was bound by the earlier High Court decision of *Nicholas Nathan Ltd v CIR* (1989) 11 NZTC 6,213 in which Justice Sinclair held fines were not allowable deductions for reasons of public policy (par [111]) :

[111] In any case, under the doctrine of precedent I am bound, by the 1989 High Court decision of *Nicholas Nathan Ltd and Anor v CIR* where Sinclair J held that deductibility of fines should not be allowed on the grounds of public policy. It would be contrary to public policy to allow such fines paid by logging transport companies to be deducted from their revenue earnings. It makes no difference to my reasoning whether the objector company incurred the fines or whether its drivers incurred them but the objector paid them. The public policy approach readily leads to denial of deductibility for fines but the nexus approach is not so easy to apply.

While sympathetic to the taxpayer, the Taxation Review Authority confirmed the assessments

JUDICIAL REVIEW GRANTED FOR DELAY

Case	Peter Allan Harris v The District Court at Auckland and CIR
Decision date	4 September 2008
Act	Income Tax Act 1994
Keywords	Judicial review, delay, informations and income tax

Summary

The taxpayers were granted application for judicial review, holding that, considering the total time taken in the prosecution, there had been undue delay, and that in the circumstances, the District Court Judge should have exercised his inherent power to prevent an abuse of process and to direct a stay of the proceedings.

Facts

On 8 November 2004, Notices under section 17 of the Tax Administration Act 1994 (TAA) were sent requesting information in support of certain returns filed by Mr Harris personally and on behalf of three companies. This resulted in a box of documents being supplied by Mr Harris to the Department; however, much of the information requested was allegedly not supplied.

From 30 November 2004 to 9 February 2005, further correspondence was issued to Mr Harris and/or his companies giving notice of intention to prosecute unless the default was remedied, which led to four informations under section 143A(1)(b) of the TAA being sworn on 25 July 2005. Those informations were replaced by fresh informations on 25 November 2005, which also alleged offences under section 143A (1) (b) of the TAA.

After various procedural steps, on 12 February 2007, the informations were ruled to be nullities as not coming within section 150A TAA and not laid within time.

Shortly after, on 16 February 2007, fresh informations were sworn in terms of section 143 (1)(b) of the TAA. After various procedural steps, the accused applied to have the informations dismissed at the 3 April 2008 fixture. Judge Burns ruled against Mr Harris, which led to these judicial review proceedings.

Decision

Application for review granted.
Order of staying prosecutions granted.

Held:

1. The informations were not out of time, as contrary to the applicant's arguments section150A of the TAA did apply.

   The effect of section 150A (2) was to restrict the extension of time to offences against the TAA that relate to:

   a. a tax law that is a provision of the Income Tax Act 2004, or
   b. a tax law that is a provision of the Goods and Services Tax Act 1985, or
   c. an obligation that exists in relation to either of those Acts, ie either the Income Tax Act or the Goods and Services Tax Act.

   The Crown submission that the obligation to provide information under section 17 of the TAA in this matter was for the purpose of administration of the Income Tax Act was accepted, which was supported by the obligation in section AA 2 of the Income Tax Act 1994 to satisfy the obligations imposed by the TAA.

2. His Honour considered that it would be premature to comment on the submissions that the informations were a nullity in any event as the District Court had not yet ruled on the issue of whether apparent defects in the dates of the alleged offending in the informations ought to be amended pursuant to section 43 of the Summary Proceedings Act 1957.

3. His Honour reviewed the leading case in relation to the application of the right under section 25(b) of the New Zealand Bill of Rights Act 1990, *Martin v District Court at Tauranga* (1995) 12 CRNZ 509 (CA), and considered that the total delay from the laying of the informations in Februrary 2007 to the hearing on 3 April 2008 was 14 months, which was not an extraordinarily long or excessive period, and could not be construed as undue. His Honour concluded that the Judge was right to find that the delay from the current prosecutions to 3 April 2008 was not such as to constitute a breach of Mr Harris' rights under section 25(b) of the New Zealand Bill of Rights Act.

4. His Honour then considered the applicant's alternative submission on delay: that the overall delay in the prosecution was such that the District Court Judge should have exercised his inherent power to prevent an abuse of process. After considering the factors to take into account when considering whether to dismiss for an abuse of process as recently summarised by Randerson J in W v R (1998) 16 CRNZ 33, his Honour considered that in the particular circumstances of this case, including the principal reason for the delay being the issuing of informations under section 143A(1)(b) of the TAA out of time (to which section 150A of the TAA did *not* apply), and the seriousness of the offending alleged, that the delay overall was so long and unjustified that it would be an abuse of process to put Mr Harris on trial for these informations now.

5. His Honour declined to disturb the Judge's discretion to deal with the issue of disclosure by adjourning the matter to allow disclosure issues to be remedied, particularly as the District Court Judge had the advantage of seeing the witness give evidence on that matter and had accepted the explanation that the disclosure issue was as a consequence of an inadvertent, accidental omission and that it was not done deliberately.

TEST FOR INTENTION/PURPOSE

Case	CIR v Boanas, Boanas, Railton and Railton (Mt Rosa Partnership)
Decision date	12 August 2008
Act	Income Tax Act 1994, Tax Administration Act 1994
Keywords	Intention/purpose, time bar, subdivision/development

Summary

The High Court clarified that the CIR does not need to look at the intentions of the individual partners but left it open for an individual partner to show a different intention or purpose from the other partners.

The High Court also discussed the intention/purpose test.

Facts

In 1993 the Railtons purchased a pastoral lease – the Mt Rosa Station. In November 1994, Mr Railton wrote to the Commissioner for Crown Lands (CCL) regarding the prospect of free holding the property under the tenure review process.

In early 1996, the Railtons discussed with the Boanas the prospect of their joining in partnership in the Mt Rosa station and the farming operation there. In April 1996, a partnership agreement was entered into between the parties; it was agreed that the partnership would be kept secret from the CCL.

On 13 May 1997, a formal agreement between the Railtons and the CCL was concluded that provided for the surrender of the pastoral lease, the division of the land into two parts and a freehold title for 1400 hectares be sold to the Railtons.

Various events occurred prior to and after 13 May 1997 in relation to the Mt Rosa Station. These included making submissions on district plans, seeking professional advice on accounting and tax issues, exploring options of using the land, seeking professional advice on using the land (eg, for subdivision, water, a four-wheel drive and a fly-by-wire venture, vineyard potential) and banking advice.

In May 1999, a conditional sale/purchase agreement was entered between the partners and Management Systems Ltd. This contract did not proceed. On 11 February 2000, the partners agreed to sell the Mt Rosa Station for $4.32 million to Antimony Investments Ltd, the shares of which were held equally by Jeremy Railton and Guy Boanas.

The Commissioner investigated and assessed the $4.32 million as assessable income to the partners. On 21 September 2005, Peter Consedine, area manager, made the assessment but the assessments were placed into account review by the computer system and not released from there until 13 October 2005. The time bar allowing for the extension under section108B TAA94 commenced on 1 October 2005.

The partners challenged the assessment and were successful in the Taxation Review Authority (TRA) on the intention/purpose issue (ie, they did not have an intention/purpose) – Case Y3, (2007) *23 NZTC 13,028*; there was also a supplementary decision – Case (2007) *23 NZTC 13,097*. The Commissioner appealed to the High Court on the intention/purpose issue. The findings of the TRA were that it was the individual partners intention/purpose that was relevant and that the building and curtilage may be apportioned and exempt under section CD1(3) of the Income Tax Act 1994. The partners cross-appealed the TRA decision that the assessments were made before the commencement of the time bar.

Decision

The High Court firstly dealt with the issue of the time bar as, logically, if the assessments were time barred there were no assessments to challenge. The Court confirmed that *CIR v Canterbury Frozen Meat Co Ltd* established the essential requirements for a valid assessment and held:

> [15] "The assessment" is that exercise of judgment by the Commissioner's delegate, and it is clearly not any particular piece of paper. It is accepted that there is no requirement to give notice of the making of an assessment to the affected taxpayer within any particular time.

> [16] The concurring judgment of McKay J emphasises that it has to be the best the Commissioner can do, on the information available to him at the time. It must represent the delegate's honest opinion on what is available to him. It cannot be arbitrary, tentative or qualified.

The Court went on to hold that Peter Consedine was unaware of the prospect of account review:

> [19] … and by the time he had signed off, he treated his work as definitive and the reflection of an honestly held opinion as to the extent of the taxpayers' liability, subject only to challenge by the disputes process.

The Court held that the position would have been different if the Commissioner's delegate was conscious at the time s/he purported to make the assessments that the assessments would thereafter be subjected to further internal review; in those circumstances the purported act of assessing the taxpayers would be conditional or less than definitive (paragraph 21).

Having determined that the assessments were not time barred, the Court went on to consider the approach the Court took on an appeal.

The Court clarified how an appeal is to be considered by the Court.

> [35] The Court is not necessarily obliged to consider for itself the entire record in order to arrive at its own view on what the correct result should be.
>
> and deference to the original decision-maker is not presumptive; see Supreme Court in *Austin, Nichols & Co Inc v Stichting Lodestar* [2008] 2 NZLR 141.

The Court then considered the law of "purpose/intent" under section CD 1(2) (a) ITA94. Firstly the Court considered what "purpose" and "intention" meant. In many situations intention will be more immediately manifested at the time of acquisition whereas a purpose may not manifest until after acquisition. A conditional purpose may constitute the requisite purpose but not in all cases; it is a question of fact and degree and the purpose or intention need only be one amongst a number of purposes or intentions.

> [57] … However, in reconstructing the purposes of a purchase, it is as if managers with delegated authority have to justify the purchase to a board of directors or the company's shareholders, in the business sense, ie Why did you buy? How do you justify having spent the money you did? Although not universally applicable, these are questions, the answers to which should reveal the purpose or object of the acquisition in cases like the present.

The Court went on to consider that, in the absence of a general capital gains tax, section CD 1 (2)(a) is, in effect, where the land is treated as if a trading asset. The requisite purpose or intention on acquisition will not necessarily manifest in plans for development or in pursuit of initiatives such as to procure zoning changes.

Having set out the legal position, the Court then considered the issue of whose purpose or intention – the individual taxpayer's or the partnership's. The Court found it was the partnership's and the Commissioner did not need to start by attempting to attribute purpose/intention on an individual basis; thus the Authority adopted the wrong approach. However, the error was not one that was material to the TRA's reasoning on the outcome as factually the partners all acted together. The Court left open that, in very limited circumstances, an individual partner may be able to establish a purpose/intention different from that of his/her partners.

The Court then analysed the factors identified and addressed by the Commissioner as preventing the partners from negating the intention/purpose. The Court finally "stood back" and tested the overall impact of these matters and:

> [129] Overall, I consider the evidence establishes a tolerably clear picture of these four taxpayers as users of the property they had free held to best advantage, rather than being a partnership that acquired the land with a purpose or intention of disposing of it, whether that was a single purpose or one among a number.
>
> and:
>
> [132] Accordingly, as the test in section CD 1(2)(a) is to be applied to the factual circumstances of this acquisition, I am satisfied that the taxpayers were correctly treated as discharging the onus on them of off-putting the existence of a purpose or intention of resale at the time of acquisition of the freehold in 1997.

The Court did not address the issue of apportionment of the buildings and curtilage for the purposes of the business premises exemption. The Court, given its finding that the partners did not have a purpose/intention, did not need to address this issue.

TRA HAS JURISDICTION TO SUBSTITUTE AN ASSESSMENT

Case	Beckham v CIR
Decision date	13 August 2008
Act	Income Tax Act 1994, Tax Administration Act 1994
Keywords	TRA jurisdiction, onus of proof, resource consent

Summary

The Taxation Review Authority has jurisdiction to substitute an available assessment where the original assessment of the Commissioner is not upheld.

Facts

In 1992 and 1993 the appellant purchased two adjoining farms at Midgley Road, Mangonui in Northland for a combined price of $444,525.66. The total property, comprising some 375 hectares, was run as a beef cattle unit.

In February 1998 the appellant entered into a conditional agreement to sell the property to a developer, Stargate Holdings Ltd, for $2.1 million plus GST. Stargate intended to subdivide and develop the property into olive groves and on 14 July 1998 obtained resource consent from Far North District Council to do so. Stargate failed to perform its obligations under the contract and in October 1999 the appellant elected to cancel the contract.

On 8 February 2000, the appellant incorporated a company, Ocean View Olives Ltd (OVO), of which he was the sole shareholder and director. On 5 April 2000 he entered into a sale and purchase agreement to sell his Midgley Road property to OVO for $1.6m plus Goods and Services Tax (GST).

On 30 March 2001, the appellant filed an income tax return for the year ended 31 March 2000. He did not include as a revenue item the proceeds of sale of the farm to OVO, which he showed as a capital transaction.

On 24 June 2002 the Commissioner issued a Notice of Proposed Adjustment (NOPA), showing the transaction as falling within paragraph (f) of section CD 1(2) of the Income Tax Act 1994 ("ITA94"). The appellant gave notice of response challenging the NOPA, which in turn led to the Commissioner issuing a disclosure notice in respect of the NOPA and a statement of position, to which the appellant issued his competing statement of position. The matter was referred to the Adjudication Unit of the Inland Revenue Department, which led to a Notice of Final Determination which confirmed the Commissioner's view that section CD 1(2) (f) of the ITA94 applied, but which also asserted that

LEGAL DECISIONS

had section CD 1(2)(f) not applied, the sale of land would have been gross income under section CD 1(2)(e)(iii)(C) (subject to certain deductions allowable under section DJ 14).

The appellant filed a notice of claim in the Taxation Review Authority (TRA) challenging the assessment, contending that the sale proceeds were not taxable under paragraph (f) and further asserting that paragraph (e) had no application.

The Commissioner's notice of defence sought to uphold the assessment under paragraph (f) but also pleaded in the alternative that in the event that paragraph (f) did not apply, the sale was gross income pursuant to paragraph (e).

The TRA upheld the appellant's contention that the proceeds of sale were not taxable under paragraph (f) but determined that they were taxable under paragraph (e). The TRA indicated that it was prepared to make an assessment in favour of the Commissioner but withheld doing so, reserving leave to the appellant to make further submissions if he so wished.

The appellant did not do so, electing to appeal the TRA's decision to the High Court. The TRA then issued a final decision on the matter, which was also appealed.

In the High Court, the appeals were consolidated and dismissed by Frater J (*Beckham v CIR* (2007) 23 NZTC 21,499). The appellant then appealed to the Court of Appeal.

Decision

The appeal was dismissed.

Held:

1) The jurisdiction challenge was inconsistent with section 16 of the Taxation Review Authorities Act 1994, section 138P of the Tax Administration Act 1994 and the decision in *Zentrum Holdings Ltd v CIR* [2007] 1 NZLR 145. The TRA clearly had jurisdiction to substitute an assessment under paragraph (e), albeit for a lesser amount than the Commissioner's original assessment.

2) The Commissioner was not required to calculate explicitly a particular threshold amount. Even if he had it would have made no difference to the outcome.

3) As to the second point, the short answer to the appellant's submissions is that paragraph (e) does tax potential value if that highest and best use derives from potential or *a fortiori*, actual resource consent. And the evidence supporting the assessment was overwhelming.

4) Further the Commissioner's submission that by section 149A of the Tax Administration Act 1994 the onus of proof lay on the taxpayer was noted, and the Court found the submission that there was a potential value above $740,000 aside from the likelihood of resource consent was without evidential support. The appellant would have had to show that the land had a pre-consent value of $1,369,105 in order to fall outside of paragraph (e), and that was plainly untenable.