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REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Policy Advice Division

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

Litigation Management

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

GET YOUR TIB SOONER ON THE INTERNET

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

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

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

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

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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

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

Ref	Draft title	Description/background information
XPB0026	Lease surrender payments received by a landlord – income tax treatment	This draft addresses the issue of whether a lease surrender payment received by a landlord in the business of renting property is (a) income under section CB 1(1) of the Income Tax Act 2007 as an amount derived from a business, or (b) income under sections CC 1(1) and CC 1(2) as an amount derived from a lease by the owner of land.
IS3571	Retirement villages – GST treatment	This draft addresses the GST treatment of payments made to the owners or operators of retirement villages and their entitlement to input tax credits on supplies received for the purpose of a retirement village.

IN SUMMARY

Binding rulings 6

BR PRD 08/02: StockCo Ltd
This ruling covers the purchase and lease-back of livestock by StockCo Ltd to farmers, and the potential repurchase of that stock by the farmers.

BR PRD 08/03: Capital Market Solutions NZ Ltd
This arrangement is the supply of services relating to the development and maintenance of NOVA software, and provision of network services by Capital Market Solutions to its New Zealand customers.

BR PRD 08/04: NZ Bloodstock Leasing Ltd
This ruling applies to the leasing of a thoroughbred breed of horse by NZ Bloodstock Leasing Ltd to customers for use in breeding bloodstock progeny.

BR PRD 09/02: BNZ Income Securities Ltd
This ruling covers the raising of capital by Bank of New Zealand and National Australia Bank Ltd. It covers the issue by BNZ Income Securities Ltd of perpetual non-cumulative shares to the public, the loan of the proceeds from that issue to BNZ Income Management Ltd, and the investment of those proceeds by BNZ Income Management Ltd in perpetual preference shares issued by BNZ. This ruling is associated with Determination S14, see page 26.

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Determination S14: Issue of perpetual non-cumulative shares by BNZIS and related transactions
This determination covers an arrangement involving the issue of perpetual non-cumulative shares by BNZ Income Securities Ltd to the public and to National Equities Ltd. The arrangement is fully described in product ruling BR PRD 09/02, see page 19.

National standard costs for specified livestock determination 2009
This determination sets the national standard costs to apply to specified livestock on hand at the end of the 2008–2009 income year.

New legislation 30

Taxation (Urgent Measures and Annual Rates) Act 2008
The new legislation introduces changes to personal income tax rates and KiwiSaver, introduces an independent earner tax credit and repeals the research and development tax credit. It also confirms the annual rates for the 2009–10 tax year. The changes take effect from 1 April 2009.

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Commissioner's right to withhold a GST refund

Contract Pacific Ltd v the Commissioner of Inland Revenue

The High Court concluded that in any investigation of a refund that engages section 46(2)(a) of the GSTA, requests for information will engage section 46(2)(b) as well. Any such requests that do not comply with the time limits in section 46(4) will cause the Commissioner to lose his authority to withhold the refund while he carries out his investigation.

Taxpayers' second judicial review successful

Chesterfields Preschools Ltd and Ors v the Commissioner of Inland Revenue

The Commissioner was found to have failed to apply the orders made in earlier judicial review proceedings and was ordered to comply with those orders.

Backdated ACC compensation not double taxed

TRA Decision Number 03/2009

The disputant received a taxable income-tested benefit and non-taxable supplementary benefits comprising disability and accommodation allowances from Work and Income for a period for which she was later determined to be entitled to weekly compensation from the ACC. The dispute arose out of what took place when ACC became the paying agency and the effect of that for tax purposes in the 2004 income year.

Supreme Court upholds common law position on proof of amount in PAYE and GST offending

Smith v R

The Supreme Court declined the appellant's application for leave to appeal on three questions of law. The overall effect of this case, together with the Court of Appeal decision, is that the general position at common law that value is not an element of an offence, unless it is the essence of the offence to continue to apply to a section 143A(1)(d) offence.

Template avoidance scheme assessments confirmed

TRA Decision Number 1/2009

Tax avoidance template scheme; repetition of arguments already dealt with by the Courts; Commissioner's assessments confirmed.

Supreme Court ruling on "Trinity"

Ben Nevis Forestry Ventures Ltd and Ors v the Commissioner of Inland Revenue

The Court concluded that the taxpayers' use of the specific provisions was not within Parliament's purpose and contemplation when it authorised deductions for the licence premiums and insurance premiums under the depreciation provisions. The taxpayers altered the incidence of income tax by means of a tax avoidance arrangement which the Commissioner correctly treated as void against him. The taxpayers were liable for the 100 percent penalty imposed by the legislation.

The Court confirmed section 76 is a general anti-avoidance provision and every avoidance issue needs to be addressed objectively on its merits

Glenharrow Holdings Ltd v the Commissioner of Inland Revenue

An arrangement was entered into by the taxpayer for the purchase of a mining licence for $45 million for which the taxpayer sought an input tax deduction. The Court found that the transaction produced a GST refund totally disproportionate to the economic burden undertaken by the taxpayer and that it very plainly defeated the intent and application of the Act.

Section 157 catches agent

38

Enterprises Lakeview Ltd v the Commissioner of Inland Revenue

The plaintiff company sought judicial review of the Commissioner's advice and receipt of funds under a statutory deduction notice which did not name the plaintiff company. The Court considered that the plaintiff company on the evidence before the Court was simply a front for the purpose of evading the tax implications. The Court considered the Commissioner's actions were justified and dismissed the application for judicial review.

Application for review on grounds of bias unsuccessful

J G Russell v the Taxation Review Authority and the Commissioner of Inland Revenue

The taxpayer applied to the High Court for review of the TRA's refusal to recuse himself from hearing the applicant's challenge. The applicant alleged presumptive bias resulting from the extensive history of litigation involving the applicant before the TRA. The application for review was dismissed by the High Court.

Commissioner's right to remove and copy electronic information

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

The High Court held that the definition of "book and document" in the TAA included computer hard drives. The Commissioner therefore had the right to remove hard drives for copying under section 16 of the TAA.

Summary judgment application for GST refund

Sadiqs as Trustees of Azura Family Trust

The plaintiffs failed in their application for a refund for their February GST return; the Commissioner had given notice of his intention to investigate within 15 days.

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**

PRODUCT RULING BR PRD 08/02

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by StockCo Limited ("StockCo").

Taxation Laws

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

This Ruling applies in respect of sections BG 1, DA 1(1), DA 2, EA 3, EC 6 to EC 27, EC 32 to EC 37, and EJ 10, subpart EW, and sections FA 6 to FA 11, FA 12, and GC 1.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of specified or high-priced livestock ("Stock") on the terms provided in the Deed of Stock Lease (the "Lease") entered into by StockCo, StockCo Holdings Limited ("StockCo Holdings") and StockCo Residual Limited ("StockCo Residual") (together the "Group Companies") and farmers and people entering the farming industry (together the "customers") for these customers to use in a farming business. Further details of the Arrangement are set out in the paragraphs below.

1 This Arrangement involves sale and lease back transactions of Stock whereby StockCo purchases the Stock, usually dairy and beef cattle and sheep, from a farmer (or third party) and then leases that Stock back to the farmer. Once the Lease is executed, StockCo assigns the Lease income to StockCo Holdings, and sells the residual value of the Stock to StockCo Residual. At the end of the Lease ("the Lease Termination Date"), the farmer may ask to purchase the Stock for its residual value. StockCo Residual is under no obligation to accept that offer.

2 The Group Companies are in the business of Stock leasing and financing.

Summary

3 StockCo has identified a market for Stock leasing in the farming industry. As at 2 September 2008, StockCo has entered into more than 100 Stock leasing transactions with various farmers. It estimates that over the next 12 months it is likely to enter into at least another 100 transactions.

4 Leases result from either one or a combination of the following two transactions:

- StockCo and the farmer enter into a sale and lease back transaction (for all or part of the farmer's Stock), whereby StockCo buys Stock from the farmer and then leases it back to the farmer.
- StockCo purchases Stock from a third party, at the farmer's request, and then leases it to the farmer.

5 The purpose of the Arrangement is for the farmers to realise capital that was tied up in Stock, retire external debt, or fund the expansion of herds, land and/or the business as a result of proceeds from the sale of their Stock. This type of Arrangement can also assist new farmers in setting up a business, as capital set-up costs can be a barrier for new farmers wanting to enter the market. This type of Arrangement also gives farmers certainty of income and expenditure that is not guaranteed under the current Stock valuation methods.

6 Farmers are responsible for maintaining the Stock and in the event of any loss of Stock, must pay the remainder of the value of that animal in full to StockCo. Should farmers seek and gain permission to cull stock, they may do so throughout the life of the Lease. In doing so, the Lease requires that the farmers act as agents for StockCo and any proceeds from the cull are returned to StockCo.

7 After the termination of the Lease, farmers may offer to purchase the Stock. However, StockCo Residual is under no obligation to accept those offers (see clause 13 of the Lease reproduced in paragraph 19). If the farmers do not purchase the Stock after the Lease expires, StockCo Residual endeavours to sell the Stock for at least the residual value of the animal, within 30 days of the Lease expiry date. Any difference between the sale price and Residual Value is paid by StockCo Residual or the farmer so the net proceeds StockCo Residual receives are exactly the market value of the Stock at the Lease expiry date.

8 Clause 2 of the Lease sets out the purchase and ownership provisions in relation to the initial sale of the Stock to StockCo.

2. PURCHASE AND OWNERSHIP OF THE STOCK.

(a) We will purchase the relevant Stock for the Purchase Price on the Commencement Date.

(b) We will EITHER:

(i) Purchase the Stock from you for the Purchase Price and will create a buyer generated invoice and will pay the Purchase Price to you on the Commencement Date or on any other agreed settlement date;

OR

(ii) Purchase the Stock from another person's and provide the same to you on the Commencement Date or any other agreed settlement date;

OR

(iii) Undertake a combination of purchase methods set out in subparagraphs 2(b)(i) and (ii) above.

(c) You covenant that the Stock will upon acquisition pursuant to this Deed be our absolute property free from any security interest and other encumbrance. You will do all things necessary and further warrant that pursuant to the transfers under clause 2(b) clear title to all of the stock referred to in the Stock Schedule has been or will be transferred to us free of any security interest or other encumbrance.

(d) You covenant that the Stock Schedule is accurate, the Stock is located on the Land and the Stock is healthy and free from disease.

(e) Legal and beneficial ownership of the Stock, free of any security interest or other encumbrance will be deemed to be transferred to us on the Commencement Date, We own the Stock.

9 Clause 3 sets out the general lease of Stock provisions:

3. LEASE OF THE STOCK. On completion of the purchase contemplated in clause 2, we will lease the Stock to you for the Term in consideration of you paying the Lease Payments, and subject to the covenants, conditions, terms, reservations and restrictions contained in this Deed, and the following clauses will apply to the Lease.

10 Once the Lease is executed, the farmers must make lease payments based on their individual cash flow. This means that dairy farmers typically make payments from December through May and dry stock farmers typically make lease payments from February through May each year of the Lease.

11 Existing farmers would enter into this Arrangement to access capital, to retire debt or to purchase additional Stock or land, or to expand their business. Such leases also help new farmers set up a business, as leases require much less start up capital than is required to purchase stock. At the end of the transaction, farmers may offer to purchase the Stock they have leased. However, StockCo Residual is under no obligation to accept those offers (see clause 13 of the Lease reproduced in paragraph 19).

12 The length of each Lease may vary up to a maximum lease period of five years for cattle and four years for sheep. Supplementary leases may be entered into in respect of replacement and/or additional Stock.

Use, treatment and obligations of farmers in respect of the Stock

13 Clause 4 of the Lease provides for the protection of StockCo's interest in the Stock and the circumstances under which the farmers have enjoyment over the Stock without interruption or disturbance from StockCo.

4. PROTECTION AND QUIET ENJOYMENT

(a) You must protect our ownership of the Stock and not attempt to sell, hire or otherwise dispose of, or deal with the Stock, in any way other than in accordance with this Deed. You will not use, or attempt to use, the Stock as security for any loans or other obligation, sell or part with possession of any Stock otherwise than in accordance with this Deed, or register, attempt to register or allow to be registered, any security interest on the Personal Property Securities Register in respect of the Stock.

(b) As long as you make all Lease Payments and duly and punctually observe and perform all your obligations under this Deed, you may peaceably possess and enjoy the Stock without interruption or disturbance from us on the terms contained in this Deed.

14 Clause 8 of the Lease contains provisions relating to the farmers expected use and maintenance of the leased Stock:

8. USE AND MAINTENANCE OF STOCK

(a) You will farm the Stock according to the best principles of good animal husbandry and take all possible care for the safety, well-being and security of the Stock and maintain the Stock's number, quality and type.

(b) All costs regarding the farming, health, levies, taxes and any other maintenance or compliance costs are payable by you.

(c) We may, at any time, determine whether you are in compliance with clause 8(a) and may employ such consultants or persons as in our absolute discretion we think fit to assist in making that determination. You must reimburse us for any fees paid by us to any such persons upon receipt of a written demand, and will pay any fees due direct to any such persons upon request by us. Any determination by us that you are not in compliance with clause 8(a) will in the absence of manifest error be final and binding on you.

15 Clause 9 of the Lease sets out the actions the farmers must take if there is a loss of any leased Stock.

9. STOCK LOSSES.

(a) If requested by us, following the death or loss of any Stock you will immediately notify us of such death or loss setting out the circumstances in which such death or loss took place and whether remedial steps have been taken to protect the remainder of the Stock. If requested by us, you will forthwith produce a report certified by a Veterinary Surgeon as to the fact and cause(s) of death.

(b) When Stock dies or is lost, irrespective of the cause of death or loss, you are responsible for the value thereof and you will either:

(i) replace the Stock with similar stock, ensuring continuing compliance with clause 8; or

(ii) pay to us by way of liquidated damages an amount equal to the total agreed lease payments relating to the Stock, less any lease payments received to date and less any rebate which we may in our absolute discretion allow you.

(c) You are responsible for the removal and disposal of any Stock which has died.

16 Clause 10 of the Lease sets out the farmer's rights and obligations in relation to annual culls, replacement and variations of leased Stock.

10. ANNUAL CULLS, REPLACEMENTS AND VARIATIONS. It is agreed that the Stock may be varied by progressive Culling and replacement of Stock, provided prior written consent is first obtained from us.

(a) **Culls.** You may from time to time seek our approval to Cull and remove Stock. Following notification (and where approval is given) you are authorised and agree to act as our agent for the removal and disposal of any animals Culled for any reason from time to time.

(b) You must notify us annually before the 30th day of June in every year, with full particulars of the number, age, breed and type of each unit of the Stock that you wish to Cull from the Flock.

(c) Following notification (and where approval is given) we will calculate and send you an invoice outlining the residual amount owed by you for all Stock Culled calculated as the total agreed lease payments relating to the Stock, less any lease payments received to date and less any rebate which we may in our absolute discretion allow you.

(d) You will pay the residual amount calculated by direct debit from your bank account on a date that is mutually agreed.

(e) You are responsible for the removal and disposal of the animals Culled from the Stock. Upon the receipt of any proceeds received as consideration for the Stock Culled, you agree to hold the proceeds as constructive trustee for us.

(f) You shall pay to us GST payable on all payments due under the Deed relating to the Stock which are culled.

(g) **Replacements.** You may from time to time seek our approval to lease from us additional Stock (whether purchased from you or otherwise acquired).

(h) Unless otherwise consented to by us, in Culling and replacing any Stock you must comply with the requirements as to maintenance of the Stock in clause 8.

17 Clause 14 of the Lease sets out the farmer's obligations in relation to identification and annual verification of the leased Stock.

14. IDENTIFICATION AND ANNUAL VERIFICATION.

(a) You must at all times ensure that the Stock is separately identifiable from any other stock that may be depastured on the Land.

(b) You must maintain complete and up to date records and details of all Stock.

(c) We may request at any time, that you will send to us a written report that certifies the number of Stock and the breed, age, quality, pregnancy status and type. Following such request, you will supply the same within 7 days.

(d) If, following such report, any Stock are missing then you will be deemed to have Culled the number of Stock so missing and the provisions of clause 10 will apply.

18 Clause 15 of the Lease sets out the parties' rights in relation to the progeny of leased Stock.

15. PROGENY.

(a) You own the Progeny.

(b) You will, upon our request grant us a first ranking security agreement over the Progeny.

(c) You will not in any way encumber or create any security interest in the Progeny without obtaining prior written consent from us.

Termination

19 On the expiry of the Lease, the farmer may offer to purchase the Stock, but StockCo Residual is under no obligation to accept that offer. Clause 13 of the Lease sets out the termination provisions:

> **13. TERMINATION.** At the expiry or earlier termination of this Deed you must, at your cost, deliver to us the Stock forthwith, and in any event within 5 business days.
>
> (a) If you fail to deliver the Stock to us in the time period specified, we may collect and remove the Stock from any property where we believe the Stock may be located, and you hereby licence us to do so, and you will be liable to us for any cost, loss, expense or liability in so collecting and removing the Stock.
>
> (b) Upon termination of this Deed, whether by way of early termination, or by expiry or otherwise we may sell the Stock to any person we choose, in our absolute discretion, using any reasonable method.
>
> (c) We reserve the right to sell the Stock at then current market value, AND in the event that we exercise such right then we will endeavour to effect sale for a price no less than the Residual Value, and to do so within 30 days after termination. Upon sale of the Stock, if the Net Proceeds:
>
> (i) are less than the Residual Value, you must pay us the difference between the Residual Value and the Net Proceeds;
>
> (ii) are greater than the Residual Value, we must pay to you the difference between the Residual Value and the Net Proceeds.
>
> (d) You may offer to purchase the Stock, but we are under no obligation to sell the Stock to you.

20 The termination provisions provide StockCo Residual will endeavour to sell the Stock within 30 days of the Lease Termination Date. The farmer may offer to purchase the Stock, but StockCo Residual is under no obligation to accept that offer.

21 Once the sale of Stock has taken place, if the net proceeds (the gross income from the sale less any expenditure) are less than Residual Value, the farmer pays the difference between the net proceeds and the Residual Value, to StockCo Residual. Alternatively if the net proceeds are greater than the Residual Value, StockCo Residual pays the farmer the difference between the net proceeds and Residual Value.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The customer is in the "business" (as defined by section YA 1) of farming.

b) The customer has entered into the Lease for the sole purpose of undertaking a farming business and intends to use the leased Stock in the production of assessable income.

c) The Stock becomes the property of the customer only if the customer makes payment of the Residual Value after the Lease Termination Date, subject to approval by StockCo.

d) The lease payments are genuine, arm's length amounts for the possession and use of the Stock.

e) At the time the lease is entered into the Residual Value of the Stock is a reasonable, and the parties best, estimate of the likely market value of the Stock at the Lease Termination Date.

f) The customer is not in the "business" (as defined in section YA 1) of selling or exchanging leases.

g) At the time of entering into each Lease, the customer does not intend to dispose of the Lease.

h) The customer is not carrying on or undertaking a scheme of trading leases entered into or devised for the purpose of making a profit.

i) The Stock, when purchased by the customer after the Lease Termination Date, are not used in, or as part of, a Stock dealing "business" (as defined in section YA 1).

j) The customers will enter into the Leases for one or a number of the following reasons which are, in each case, the main reasons for entering into the Arrangement:

- The need to refinance livestock already owned for further investment in the farming business or to retire existing debt;
- The need for certainty of cash flows through structuring the lease payments;
- The need for certainty of income and expenditure; and/or
- The need to reduce the initial level of cash required to enter the farming industry or to purchase new livestock.

How the Taxation Laws apply to the Arrangement

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

- The Stock lease payments are deductible under section DA 1(1) and none of the general limitations in section DA 2 apply to prevent deductibility, provided that:
  - (i) no provision in subparts DB to DZ applies to prevent a deduction in section DA 1(1); and
  - (ii) the income arising from the Arrangement is derived by the customer in New Zealand.
- The valuation provisions in sections EC 6 to EC 27 apply to the customer when the "specified Stock" (as defined in section YA 1) is purchased by payment of the Residual Value after the Lease Termination Date.
- The valuation provisions in sections EC 32 to EC 37 apply to the customer when the "high-priced Stock" (as defined in section YA 1) is purchased by payment of the Residual Value after the Lease Termination Date.
- The cost price of the "specified livestock" (as defined in section YA 1) for the purposes of sections EC 6 to EC 27, for customers purchasing that Stock at the end of the Lease, is the Residual Value stated in the Lease.
- The cost price of the "high-priced livestock" (as defined in section YA 1) for the purposes of sections EC 32 to EC 37, for customers purchasing that Stock at the end of the Lease, is the Residual Value stated in the Lease.
- At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, section EA 3 applies to require the unexpired portion of any lease payments paid in advance to be included in the customer's income in the current income year and to be an amount for which the customer is allowed a deduction in the following income year.
- The financial arrangements rules in subpart EW do not apply to the Arrangement.
- Section EJ 10 does not apply to the Arrangement as the Lease is not an operating lease.
- Sections FA 6 to FA 11 do not apply to the Arrangement as the Lease is not a finance lease.
- Section FA 12 does not apply to the Arrangement as the Lease is not a hire purchase agreement.
- Section GC 1 does not apply to any sale of the livestock to the customer at the Lease Termination Date.
- Section BG 1 will not apply to negate or vary any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2008 and ending on 31 March 2011.

This Ruling is signed by me on the 20th day of November 2008.

Howard Davis
Director (Taxpayer Rulings)

PRODUCT RULING BR PRD 08/03

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Capital Market Solutions NZ Limited ("CMS").

Taxation Laws

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

This Ruling applies in respect of sections 8(4B), 11A(1)(j) and 76.

This Ruling does not consider or rule on any "telecommunications services" (as defined in section 2) supplied by CMS.

The Arrangement to which this Ruling applies

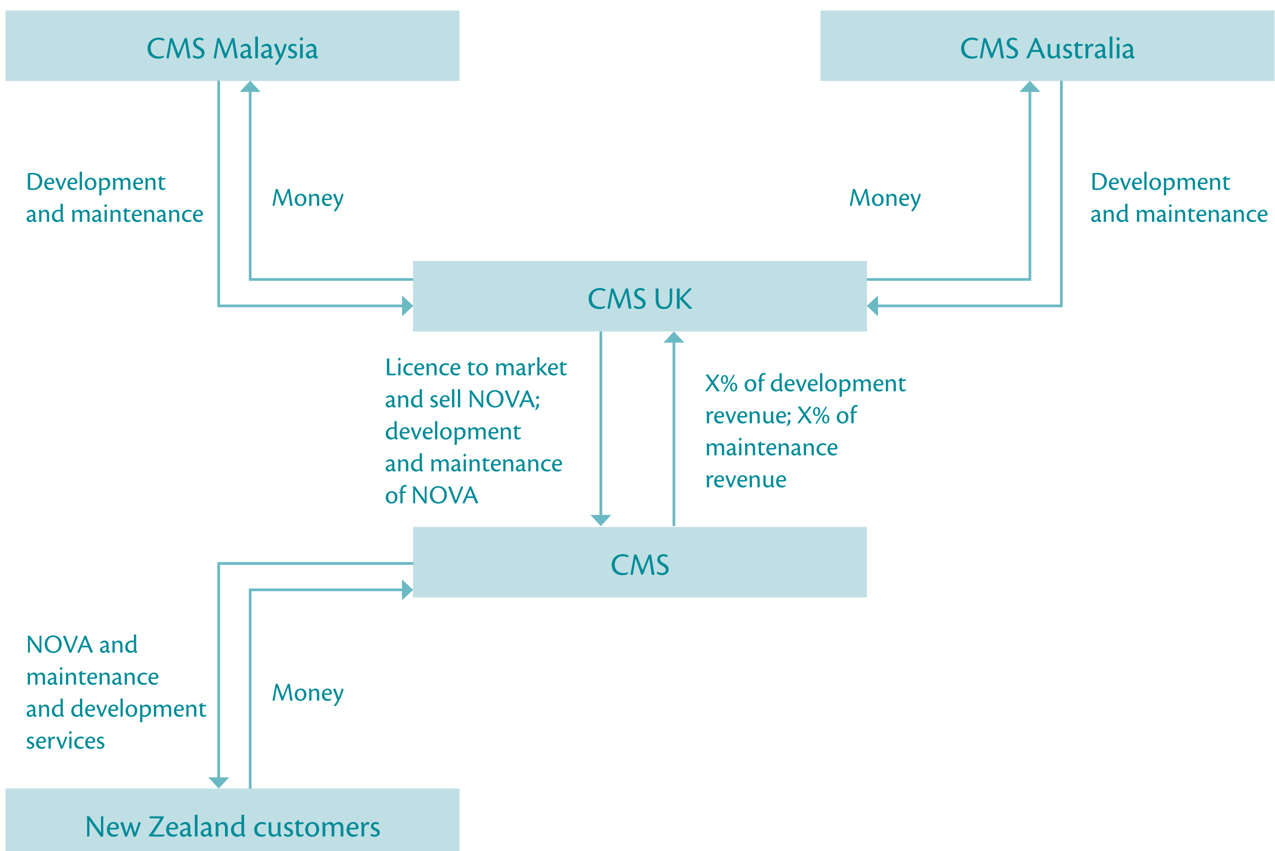
1 The Arrangement is the supply of services relating to the development and maintenance of NOVA software and provision of network services (some of which include "telecommunications services" (as defined in the Act)) by CMS to its New Zealand customers.

2 CMS installs NOVA for its New Zealand clients and supplies maintenance and development services. Most New Zealand clients provide financial services (including stock-broking services) to their customers.

3 Further details of the Arrangement are set out in the paragraphs below.

Details of the Arrangement

4 The Arrangement is summarised in the diagram below and discussed in subsequent paragraphs.



Description of NOVA

5 NOVA is stock-broking computer software that, among other operations, interfaces with stock exchanges and clearing and settlement agencies. It allows for real-time market execution uploads and the automatic settlement and accounting of securities processing. Other functions include client data management, trade booking and allocations, settlements (local and international), margin trading, stock borrow lending, custody, corporate actions and accounting.

Agreement between CMS UK and CMS Licence Agreement

6 Capital Market Solutions (UK) Ltd ("CMS UK") has granted to CMS the non-exclusive marketing rights to NOVA in New Zealand. This transaction is governed by the Licence Agreement.

7 CMS UK supplies NOVA and all related information techniques and procedures to CMS. Clause 3(a) of the Licence Agreement provides that CMS has the right to distribute NOVA in New Zealand.

> **3. GRANT OF RIGHTS**
>
> (a) The Company hereby confirms that on the Commencement Date the Company granted to the LICENCEE for the consideration hereinafter mentioned a licence to sub-licence the SYSTEM throughout the Territory subject to termination according to the terms of this Agreement set out below provided that the rights of any End User granted and existing during the term of this Agreement shall not be prejudiced or cease on account of the termination or expiration of this Agreement but shall survive and remain enforceable and provided that nothing in this Agreement shall operate to transfer the Company's rights in the SYSTEM to the LICENCEE.

8 Clause 5 of the Licence Agreement states that CMS UK undertakes to develop and extend NOVA if CMS so requests, so far as it is commercially reasonable.

> **5. DEVELOPMENT AND CUSTOMISATION**
>
> (a) The Company agrees and undertakes to develop and extend or to procure the development and extension of the SYSTEM so far as it is commercially reasonable to do so and so far as it is able to do so using all reasonable endeavours, and to provide new versions and applications of the SYSTEM (if any) as and when they become available. The Company's obligations under this sub-clause do not extend to any modification or customisation of the SYSTEM under sub-clause 5(b).
>
> (b) In order to assist the LICENCEE to satisfy its obligations under an End User Agreement, the Company agrees and undertakes to modify or customise or procure the modification or customisation of the SYSTEM in accordance with the terms of any request made by the LICENCEE.

9 Clause 5(b) states that CMS UK will modify or customise NOVA, or arrange to have modification or customisation done, if CMS requests modification or customisation. This will be based on requests made by a customer under any contract between CMS and that customer. No contractual relationship exists between CMS UK or companies that CMS UK engages to modify NOVA ("other CMS companies") and the New Zealand customer. CMS, not the New Zealand customer, conducts all interaction with CMS UK or other CMS companies.

10 Clause 6(a) of the Licence Agreement states that CMS UK provides maintenance of the NOVA product in accordance with the obligations CMS entered into with its customers. Clause 6(b) of the Licence Agreement states that CMS will provide its customers with support for NOVA.

> **6. MAINTENANCE**
>
> (a) In consideration for the payment of the fees specified in clause 7 the Company shall provide or procure the provision of maintenance of the SYSTEM in accordance with the obligations entered into in each End User Agreement for maintenance subject to such agreement having received the prior written approval of the Company.
>
> (b) The LICENCEE undertakes to provide End Users with support for the SYSTEM such support to include help with problem solving and applications of the SYSTEM and generally to liaise with End Users so as to identify problems such End Users may encounter with the use of the SYSTEM.

11 Payments are governed by Schedule 1 of the Licence Agreement. Schedule 1 states that CMS retains X% of the maintenance revenue received from its customers and X% of the development revenue. CMS UK receives X% of the maintenance revenue and X% of the development revenue.

Agreements between CMS and its New Zealand customers

12 The contracts and schedules governing the relationship between CMS and its New Zealand customers are the:

- General Terms and Conditions of Business ("General Terms");
- Licence Specific Agreement, including:
  - Schedule 1
  - Schedule 2, and
  - Schedule 3
- Software Management Specific Agreement ("SMS Agreement") (originally entitled the Maintenance and Systems Management Agreement, which is materially the same), including:
  - Schedule 1, and
  - Schedule 2
- Professional Services Specific Agreement ("PSS Agreement") (originally entitled the Development Services Specific Agreement, which is materially the same), including the:
  - Schedule of Work (Implementation and Development) (originally entitled the Schedule of Development Work, which is materially the same).

General Terms and Conditions of Business

13 CMS and the customer enter into the General Terms, which govern the provision of services and products to CMS's customers. Separate documents govern the specific requirements that CMS and the customer contract to have performed. The specific terms most relevant for our purposes are contained in the Licence Specific Agreement (discussed in paragraphs 16–21).

14 The General Terms provide that if a Specific Agreement and the General Terms are inconsistent, the Specific Agreement will prevail.

> **2. Specific Agreement(s)**
>
> 2.1 Any Specific Agreement(s) submitted by CMS to the Client is subject to these General Terms. In the event of any inconsistency between a Specific Agreement and these General Terms the terms of the Specific Agreement shall prevail.

15 The other terms in the General Terms include confidentiality, liability, copyright, risk insurance, termination and other general matters.

Licence Specific Agreement

16 CMS enters into the Licence Specific Agreement with its customers. The Licence Specific Agreement has three schedules.

17 Schedule 1 of the Licence Specific Agreement stipulates which NOVA program modules CMS will provide, the maximum number of concurrent users that may use NOVA, and that CMS will supply NOVA implementation and development services to the customer.

> **V. SERVICES**
>
> CMS shall supply to the Client the following estimated services in relation to the Computer System:-
>
> **1. Implementation**
>
> X man days
>
> **2. Development**
>
> The development services under this Agreement are provided under the terms of the Development Services Specific Agreement.

18 At the commencement of a project, CMS assesses how many days it will need to implement NOVA for the customer. Following commercial negotiation, CMS and the customer agree how much the customer will pay for the implementation services. NOVA implementation times differ depending on the level of complexity. CMS negotiates payment terms for implementation services with the customer. These terms vary, depending on the circumstances of each deal. Usually, payments are required as the services are performed.

19 Schedule 2 of the Licence Specific Agreement governs the delivery date and commencement of services.

20 Schedule 3 of the Licence Specific Agreement details the charges for the NOVA software and charges for implementation.

> **SERVICES and CLIENT ADDITIONAL PROGRAMS**
>
> Notwithstanding anything contained within the Licence Specific Agreement to the Contrary CMS has agreed to provide the Services listed in Schedule 1 Paragraph V at a fixed price of $X
>
> This is made up of:
>
> Implementation X days @ NZ$X per day.

21 All implementation is physically performed in New Zealand except for very small amounts of implementation which are physically performed outside New Zealand.

Software Management Specific Agreement

22 The SMS Agreement is between CMS and its customer. Under this agreement, CMS undertakes to carry out certain maintenance services. The agreement has two schedules.

23 Schedule 1 of the SMS Agreement governs the severity level categorisation of any maintenance requested or the type of any enhancement requested. The schedule also governs CMS's target response times to requests.

24 Schedule 2 of the SMS Agreement states the charges for the monthly maintenance services CMS provides to its customers. These monthly maintenance services can include:

- software maintenance services
- equipment (including maintenance)
- systems and facilities management service
- NOVA network service

25 With the exception of software maintenance services, some customers may choose to source these services themselves and therefore will not be charged by CMS. Some of the NOVA network services CMS supplies constitute "telecommunications services" (as defined in the Act). Customers who choose to source network services and equipment rental directly handle almost all facilities management requirements themselves. CMS provides only a few basic facilities management services as part of its maintenance services.

Professional Services Specific Agreement

26 CMS and the customer enter into a PSS Agreement, which states the process by which the customer may request development services. The PSS Agreement defines "professional services" as:

"Professional services" means the implementation, installation and/or development services more particularly described in the Schedule of Work

27 The PSS Agreement includes a Schedule of Work (Implementation and Development).

Schedule of Work (Implementation and Development)

28 The Schedule of Work (Implementation and Development) contains the contract price for the requested man-days of implementation services to the customer. Implementation services relate to implementing and configuring services in respect of the software (NOVA). The Schedule of Work also contains a separate contract price for man-days of development services to the customer. Development services relate to programming and related professional services in respect of the software.

29 Before CMS agrees to any development work, it undertakes a workshop with the customer to determine the amount of development required to address the customer's particular development requirements. After this workshop, CMS assesses the number of "man-days" required for development. After commercial negotiation, CMS reaches agreement with the customer about how much the customer will pay for development services. When the agreement is reached, CMS delivers the standard NOVA software so the implementation project and development services can start. Customers are likely to require CMS to provide development services after NOVA "goes live", for example, for additional functionality or for further reports to be prepared.

30 Under clause 2.1 of the Schedule of Work (Implementation and Development), CMS agrees to provide a negotiated number of man-days for implementation services.

2. DESCRIPTION AND USE OF IMPLEMENTATION SERVICES

2.1 In consideration of the Contract Price, set forth in clause 4.1 below CMS agrees to provide the following (estimated) number of Man-days of implementation professional services to the Client.

	Number of Man-days
Project Management	X
Implementation Consultants	X
Technical Consultants	X
Training Consultants	X

These services are hereinafter collectively referred to as the "Implementation Services".

2.3 The Implementation Services relate only to implementing and configuration services in respect of the software and/or Programs known as NOVA and associated activities. The Implementation Services are more particularity described in Annex 1 of this Schedule of Work.

31 CMS also provides a negotiated amount of man-days for development work.

3. DESCRIPTION AND USE OF DEVELOPMENT SERVICES

3.1 In consideration of the Contract Price, set forth in clause 4.2 below CMS agrees to provide the following (estimated) number of Man-days of development services to the Client.

Type	Number of Man-days
Development Services	X

These services are hereinafter collectively referred to as the "Development Services".

32 The customer agrees to pay CMS for these man-days. CMS negotiates payment terms for development services with the customer. Terms vary, depending on the circumstances of each deal. Usually, payments are required as the services are performed.

4. PAYMENT TERMS & PRICE INCREASES

4.1 The Contract Price for the provision of Implementation Services referred to herein is for a fixed price of $X (plus applicable GST) which shall be payable in accordance with the terms of Annex 3 part A.

4.2 The Contract Price for the provision of Development Services referred to herein is for a fixed price of $X (plus applicable GST) which shall be payable in accordance with the terms of Annex 3 part B.

33 In summary, CMS enters into a series of contracts and schedules with a customer. These contracts and schedules provide the implementation, professional and network services that CMS will supply to the customer and the price the customer will pay. Some of these services are carried out in New Zealand, while some are carried out outside New Zealand.

Services performed in New Zealand

34 The services performed in New Zealand are as follows.

Service	Governing Agreement
Almost all implementation	Licence Specific Agreement
First line support	SMS Agreement
Systems and facilities management	SMS Agreement
Reports development	PSS Agreement; Schedule of Work (Implementation and Development)

Services performed outside New Zealand

35 The services performed outside New Zealand are as follows.

Service	Governing Agreement
Some development services	Schedule of Work (Implementation and Development)
Almost all of the software maintenance services	SMS Agreement
Some of the NOVA network services	SMS Agreement

36 Almost all implementation is carried out in New Zealand. Some development services are carried out overseas, as are almost all the software maintenance services. NOVA is an off-the-shelf product, so needs to be customised to meet additional customer requirements. The customer enters into the above contracts with CMS to supply these services. CMS then contacts CMS UK and details the services required and modifications to be made. CMS UK then contracts other CMS companies to make these modifications and carry out these services. Some NOVA network services (which include "telecommunications services" (as defined in the Act)) are also carried out overseas.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions.

a) The network services, development services and software maintenance services apportioned at a 0% GST rate are physically performed outside New Zealand.

b) The network services, development services and software maintenance services physically performed outside New Zealand and charged at a 0% GST rate are indicated on any invoices provided to the New Zealand resident customer.

c) CMS UK and CMS do not have an agency relationship.

d) The services physically performed outside New Zealand are priced on an arm's length, market basis.

e) The services physically performed in New Zealand are priced on an arm's length, market basis.

f) CMS contracts to have some services physically performed outside New Zealand for the following reasons:

   (i) There are economies of scale in having a centralised development centre outside New Zealand; and

   (ii) There are lower development costs in having services physically performed outside New Zealand.

How the Taxation Laws apply to the Arrangement

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

- The supply by CMS of network services, development services, and software maintenance services to its New Zealand customers may be charged at a 0% GST rate to the extent that those services are physically performed outside New Zealand, provided those services are not "telecommunications services" (as defined in section 2).
- Section 8(4B) does not apply to the supply of services by CMS to its New Zealand customers.
- Section 76 does not apply to negate or vary any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 March 2008 and ending on 31 October 2011.

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

Martin Smith
Chief Tax Counsel

PRODUCT RULING BR PRD 08/04

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by New Zealand Bloodstock Leasing Limited ("NZBL").

Taxation Laws

All legislative references are to the Income Tax Act 2004 unless otherwise stated.

This Ruling applies in respect of sections GD 1, EA 3, EJ 9, FC 8, FC 9, FC 10, EC 38 to EC 48, DA 1, DA 2, and BG 1 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of a thoroughbred breed of horse ("bloodstock") on the terms provided in the Bloodstock Lease to Purchase Agreement ("Bloodstock Agreement") entered into by NZBL and its customers for customers to use in breeding bloodstock progeny.

Further details of the Arrangement are set out in the paragraphs below.

Purpose of the Arrangement

1 NZBL, New Zealand Bloodstock Limited ("NZB"), New Zealand Bloodstock Finance Limited ("NZB Finance") and New Zealand Bloodstock Progeny Limited ("NZB Progeny") are all 100% owned subsidiaries of New Zealand Bloodstock Holdings Limited ("NZB Holdings"). Together, they are referred to in this ruling as the "NZB Group".

2 NZB established NZBL to expand its business and increase sales of bloodstock in New Zealand by making investment in the bloodstock industry more attractive to existing and new entrants. The availability of leasing reduces the initial level of cash required by existing and new entrants to the bloodstock business to acquire bloodstock. The leasing arrangement gives the customers the opportunity to participate in the business of breeding bloodstock by leasing the bloodstock. NZB is contractually entitled to provide the auctioning services for any progeny of the bloodstock. The benefit for the NZB Group from the leasing arrangement is that NZB gets the commissions from selling the bloodstock and the commissions from any sale of progeny from the bloodstock, in addition to NZBL's right to receive the lease payments.

Sourcing of the bloodstock

3 NZBL acquires new bloodstock from third party owners, and then leases this bloodstock to the customer. Alternatively, the customer purchases the new bloodstock from the third party owner, sells it to NZBL, and then leases the bloodstock from NZBL. This helps to protect NZBL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases, the parties contemplate the transaction as a whole at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.

4 NZBL may also acquire bloodstock that is already owned by the customer, either through an earlier purchase or because it is homebred (the "already owned bloodstock") and the proceeds or sale of the already owned bloodstock are only used for further investment in the customer's bloodstock breeding business.

5 It is agreed in the Bloodstock Agreement that the customer may purchase the bloodstock at the end of the lease. The Bloodstock Agreement describes the Arrangement:

> WHEREAS
>
> A. The Lessee has requested the Lessor to purchase the Animal described in the Schedule hereto (hereinafter called 'the Animal') and upon purchase thereof to lease and, if required, to re-sell the Animal to the Lessee in accordance with the terms hereof.
>
> B. The Lessor has purchased the Animal and has agreed to lease the Animal to the Lessee and the Lessee has agreed to lease the Animal with the right to purchase it upon the terms and conditions more particularly outlined herein.
>
> C. The Animal secures the payment or performance of the Lessee's obligations hereunder and this Agreement creates a security interest in the Animal in terms of the Personal Property Securities Act 1999.
>
> D. The Lessor has agreed to this Lease to Purchase Agreement for the specific purpose of assisting the Lessee in the business of breeding bloodstock for sale by adding to its inventory and upon the basis that the Lessee, if it wishes to sell the leased animal or, if a mare, the progeny thereof, will sell the same through the bloodstock auctions conducted by its parent company New Zealand Bloodstock Limited.
>
> E. The Lessee has entered into this agreement for the purpose of obtaining breeding stock to use in the Lessee's business of bloodstock breeding for sale.

Lease particulars

6 The terms and duration of leases are based on individual requirements, credit risk, and potential breeding expectations. Lease periods may vary but a typical lease term is three years for fillies or mares and two years for colts or stallions.

Lease assignment

7 When the lease is executed, NZBL assigns the lease to NZB Finance for the discounted value of the cash flow. The discount is equivalent to the market rate offered by third party companies providing such financing facilities. The assignment is on a non-recourse basis, and NZBL is not liable to NZB Finance in the event of default by the lessee. The Notice of Assignment describes this assignment as:

> TAKE NOTICE that on the New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows
>
> (a) To New Zealand Bloodstock Finance Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the leasing of the Animal under the said Agreement and without limiting the generality of the foregoing all of the rights of the Lessor to receive payments of rental as and when they shall become due or other monies payable under the said Agreement by the Lessee to the Lessor or in respect of the Lessor enforcing such rights and receiving such payments as are prescribed by the said Agreement.
>
> You are directed to pay all payments of rental due under the said Agreement and all other payments due in respect of the lease of the Animal therein described to the said New Zealand Bloodstock Finance Limited and in future to deal with that company in respect of all matters pertaining to the leasing arrangement under the said Agreement.

Residual Value

8 The bloodstock has a defined Residual Value under the Bloodstock Agreement. The Residual Value is an estimate (at the time the lease is signed) of the value the bloodstock will have at the end of the lease. The term "Residual Value" is defined in the Bloodstock Agreement as:

> 'Residual value' means the amount specified in the Schedule hereto as such being a pre-estimate of the value of the Animal upon the expiry of this Lease.

Bloodstock assignment

9 After the lease has been entered into and assigned to NZB Finance, NZBL assigns the title to the bloodstock to NZB Progeny. Because the Residual Value, if realised at all, is not realised by NZB Progeny until the end of the lease, NZB Progeny pays to NZBL the discounted value of the residual value payment. The discounted value is calculated using market rates materially the same as those used by third party companies providing financial facilities.

10 Transferring the bloodstock titles to NZB Progeny gives additional asset protection benefit to the New Zealand Bloodstock group. In this way the group's interest in the bloodstock is separated and protected from the day to day business activities of NZB, NZB Finance and NZB Leasing. The Notice of Assignment from NZBL to the lessee describes this assignment as:

> TAKE NOTICE that on the New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows
>
> (a) …
>
> (b) To New Zealand Bloodstock Progeny Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the title to and property in the Animal and the right to receive payment of the Residual value outlined in the said Agreement and any other monies due under the said Agreement in respect of the title to or ownership of the Animal.
>
> You are directed to pay the amount of Residual Value of the Animal on the date payable under the said Agreement to New Zealand Bloodstock Progeny Limited and in future to deal with that company in respect of all matters relating to the ownership and wellbeing of the Animal(s).

Lease Termination Date

11 The "Lease Termination Date" is the date on which the lease ends. The customer may purchase the bloodstock on the Lease Termination Date for the Residual Value. If the customer does exercise their option to purchase the bloodstock, NZB Progeny will transfer title to the customer in return for payment of the Residual Value.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The customer is in the "business" (as defined in section OB 1) of breeding bloodstock.

b) Where the bloodstock is already owned bloodstock, the customers will enter into the Bloodstock Agreement for one or both of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:

- The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business, and/or

- The need for certainty of cash inflows for further investment in the customer's bloodstock breeding business through the sale of the bloodstock to NZBL.

c) Where the bloodstock is new bloodstock, the customers will enter into the Bloodstock Agreement for one or a number of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:
   - The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business
   - The need for certainty of cash outflows through structuring the lease payments, and/or
   - The need to reduce the initial level of cash required to enter the bloodstock breeding business or to purchase new bloodstock.

d) The customer has not entered into two or more consecutive or successive leases (within the meaning of paragraph (d)(iv) of the "lease" definition in section OB 1, if the reference to "the same personal property lease asset" is read as a reference to "the same bloodstock") of the same bloodstock.

e) The customer has entered into the Bloodstock Agreement for the sole purpose of breeding from the leased bloodstock and intends to use the leased bloodstock in deriving the assessable income.

f) The lease payments are genuine, arm's length amounts for the possession and use of the bloodstock.

g) The leased bloodstock is mature for use in breeding and is capable of being used for breeding at all times during the period to which each lease payment relates.

h) Any racing undertaken by the leased bloodstock is incidental to the actual use of the bloodstock for breeding during the lease term.

i) The Residual Value of the bloodstock is a reasonable, and the parties' best, estimate of the likely market value of the bloodstock at the Lease Termination Date.

j) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.

k) No consideration is paid for the option to purchase the bloodstock at the Lease Termination Date.

l) The customer is not in the "business", as defined in section OB 1, of selling or exchanging leases.

m) At the time of entering into the Bloodstock Agreement, the customer does not intend to dispose of the lease.

n) The customer is not carrying on or undertaking a scheme of trading leases entered into or devised for the purpose of making a profit.

How the Taxation Laws apply to the Arrangement

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

- The bloodstock lease payments are deductible under section DA 1(1) and none of the general limitations in section DA 2 apply, provided that:
  - (i) no provision in subparts DB to DZ applies to prevent a deduction in section DA 1(1), and
  - (ii) the income arising from the Arrangement is derived by the customer in New Zealand.
- At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, section EA 3 applies to require the unexpired portion of any lease payments paid in advance to be included in the customer's income in the current income year and to be an amount for which the customer is allowed a deduction in the following income year.
- The financial arrangements rules in subpart EW do not apply to the Arrangement.
- Section EJ 9 does not apply to the Arrangement as the lease is not an operating lease.
- Sections FC 8A to FC 8I do not apply to the Arrangement as the lease is not a finance lease.
- Sections FC 9 and FC 10 do not apply to the Arrangement as the lease is not a hire purchase agreement.
- The valuation and specified write-down provisions in sections EC 38 to EC 48 apply to the customer when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date.
- The "cost price" of the bloodstock for the purposes of sections EC 38 to EC 48 is the Residual Value stated in the Bloodstock Agreement.
- Section GD 1 does not apply to the sale of the bloodstock to the customer.
- Section BG 1 will not apply to the Arrangement to negate or vary any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 5 December 2007 and ending on 5 December 2012.

This Ruling is signed by me on the 18th day of December 2008.

Howard Davis
Director (Taxpayer Rulings)

This ruling BR PRD 09/02 is associated with Determination S14 on page 26.

PRODUCT RULING BR PRD 09/02

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by BNZ Income Securities Limited ("BNZIS").

Taxation Laws

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

This Ruling applies in respect of sections BG 1, CX 56(3) and GB 35.

The Arrangement to which this Ruling applies

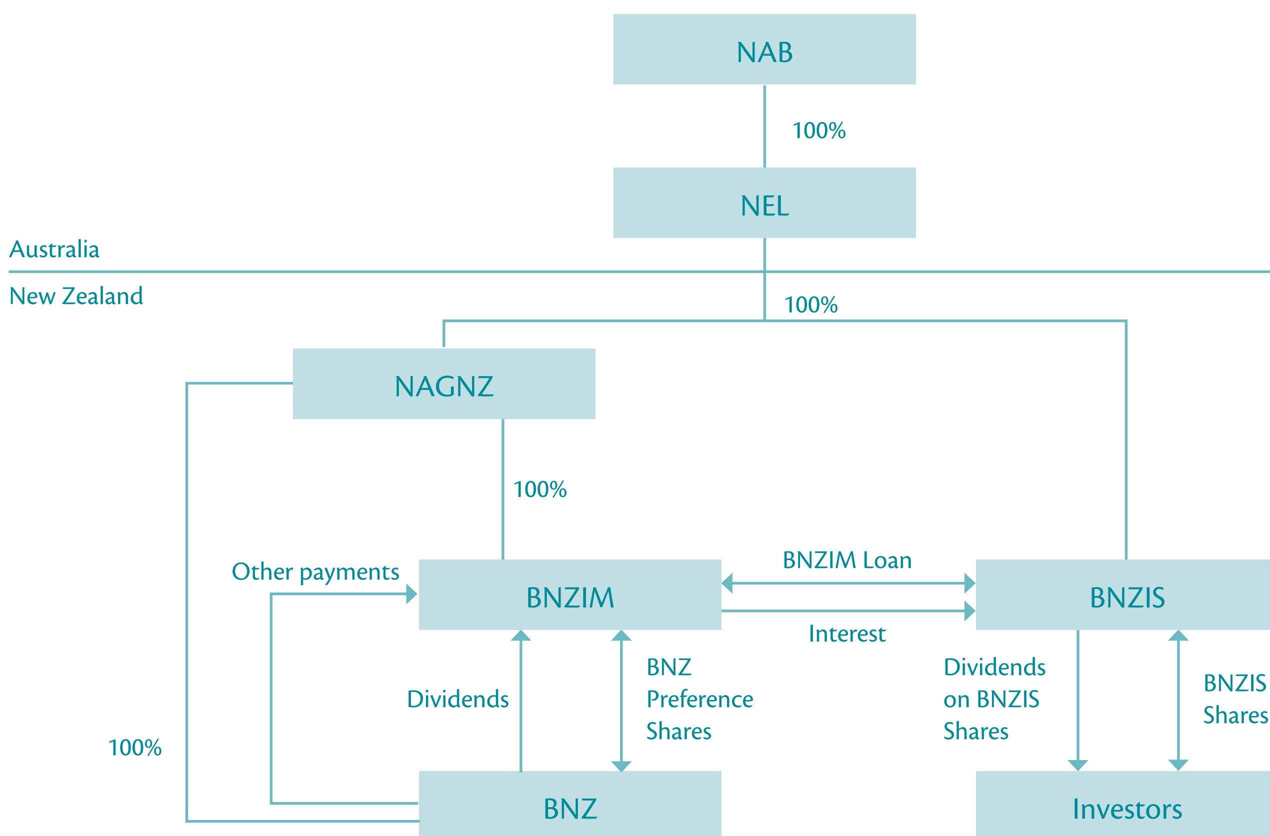
The Arrangement involved the raising of capital by Bank of New Zealand ("BNZ") and National Australia Bank Limited ("NAB"). BNZIS issued perpetual non-cumulative shares ("BNZIS Shares") to members of the public ("BNZIS Shareholders"). BNZIS lent the proceeds raised from the issue to BNZ Income Management Limited ("BNZIM"). BNZIM invested the proceeds of that loan ("BNZIM Loan") in perpetual preference shares issued by BNZ ("BNZ Preference Shares"), and, in turn, BNZ used the proceeds for general corporate purposes.

There was, at the time the Arrangement was entered into, and is no intention on the part of the Board of Directors of BNZ and/or NAB that the BNZ and/or NAB would promote the acquisition of BNZIS Shares by providing investors with a loan or other financing from any of the companies in the BNZ or NAB group.

This Ruling does not apply to any investor who or which has funded the acquisition of BNZIS Shares by means of borrowing or other financing from any of the companies in the BNZ or NAB group of companies, where such borrowing or other financing was part of an express agreement or arrangement (whether in writing or otherwise) with such entity that the proceeds of some or all of such borrowing or other financing would be used for the purposes of acquiring BNZIS Shares.

Further details of the Arrangement are set out in the paragraphs below.

1. The material terms of the transactions comprising the Arrangement are governed by the following documents (which were provided to Inland Revenue on either 11 April 2008 or 22 July 2008):
   - BNZIM Loan Agreement, dated 25 February 2008, between BNZIS and BNZIM
   - BNZIS Deed Poll, dated 25 February 2008, entered into by BNZIS in favour of the BNZIS shareholders
   - Security Trust Deed, dated 25 February 2008, between BNZIM, BNZIS and New Zealand Permanent Trustees Limited
   - Constitution of BNZ
   - Constitution of BNZIS
   - Committed Cash Advances Facility Agreement, between BNZ and BNZIS, dated 25 February 2008
   - Administration Agreement, between BNZ and BNZIS, dated 25 February 2008.
2. Also provided to Inland Revenue on 11 April 2008 was a copy of the Combined Investment Statement and Prospectus regarding the Offer of Perpetual Non-cumulative Shares by BNZIS, dated 25 February 2008 ("Prospectus").
3. The Arrangement is summarised in the diagram below and discussed in subsequent paragraphs.



4 The Australian Prudential Regulatory Authority ("APRA") currently treats the BNZIS Shares as innovative residual tier 1 capital for NAB on a level 2 basis. The Reserve Bank of New Zealand currently treats the BNZ Preference Shares as tier 1 capital for BNZ.

BNZIS

Incorporation of BNZIS

5 BNZIS is a special purpose company incorporated on 29 January 2008 under the Companies Act 1993 and intended to be tax resident solely in New Zealand. BNZIS was incorporated with 100 ordinary shares of $1.00 each, all of which are held by National Equities Limited ("NEL"). NEL is a 100% subsidiary of NAB and is incorporated and tax resident in Australia. BNZIS subsequently issued a further 10,500,000 ordinary shares to NEL. It issued a further tranche of 50,468 ordinary shares to NEL on 29 May 2008 to cover additional establishment costs in excess of the initial ordinary share issues.

6 The ordinary shares carry all of the voting rights in BNZIS but carry no right to a distribution in any circumstances.

7 Under the relevant accounting standards, BNZIS is a member of the NAB consolidated group ("NAB Group").

BNZIS Constitution

8 BNZIS has no power to carry on any business or activity other than that described in the BNZIS Constitution, which was lodged with the Companies Office on 25 February 2008.

9 Clause 4.1 of the BNZIS Constitution states:

Limitation on Business: The only business or activity which the Company may carry on is to:

(a) issue and maintain in existence perpetual non-cumulative shares, including listing (and maintaining a listing of) those shares on any stock or securities exchange in New Zealand or elsewhere;

(b) advance the proceeds of perpetual non-cumulative shares to BNZIM, or a Related Company of that company pursuant to one or more loan agreements;

(c) enter into the Administration Agreement, the Committed Cash Advance Facility Agreement, the Security Trust Deed, the Loan Agreement, the Registration Agreement and the Deed Poll (and any other administration agreements, committed cash advance facility agreements, security trust deeds, loan agreements, registration agreements and/or deed polls in connection with the issue of perpetual non-cumulative shares);

(d) do all other things reasonably incidental to the activities referred to in paragraphs (a), (b), (c) and this Constitution.

The Company has no power to:

(e) carry on any other business or activity; or

(f) apply amounts received by way of interest on, or repayment of, the loans referred to in paragraph (b) for any purpose other than in payments to the holders of the perpetual non-cumulative shares, meeting costs and expenses incurred in connection with the issuance and maintenance in existence of perpetual non-cumulative shares and making income and other tax payments to the New Zealand Inland Revenue Department.

10 BNZIS elected to be a portfolio investment entity ("PIE", as defined in section YA 1) with a commencement date of 28 March 2008.

11 Under the BNZIS Constitution, the directors of BNZIS are granted powers to take all steps considered necessary or desirable to ensure BNZIS continues to be eligible to be a PIE and qualify as a "portfolio listed company" ("PLC", as defined in section YA 1) under the requirements set out in the Act . These requirements include (but are not limited to):

- rejecting applications for, or transfers of, BNZIS Shares (clauses 6.16 and 6.17 of the Constitution)
- deeming any BNZIS Shares held that exceed the "investor interest size" requirements specified in the Act to be held by the BNZIS Shareholder on trust for any company in the NAB Group appointed by BNZIS and allowing such shares to be sold by that company (clause 6.17 of the Constitution)
- allowing BNZIS to request any BNZIS Shareholder to provide such information as it may require to determine whether BNZIS continues to meet the PLC requirements set out in the Act and, where holders do not provide such information within relevant periods, providing that the relevant BNZIS Shares are held on trust by the holder thereof for any company in the NAB Group appointed by BNZIS and allowing such shares to be sold by that company (clause 6.17 of the Constitution)
- taking any of the steps in clause 6.18 of the Constitution to ensure any breach of the "investor interest size" requirement is remedied within the period specified in the Act.

BNZIS Shares

12 BNZIS issued the BNZIS Shares under a public offer in New Zealand pursuant to the Prospectus referred to at paragraph 2. Clause 1.4 of the Prospectus states:

1.4 OFFER IN NEW ZEALAND ONLY

The Shares are being offered only to New Zealand residents and no offer is being made outside New Zealand. Accordingly, this Offer Document does not constitute an offer of the Shares in any jurisdiction other than New Zealand. No action has been or will be taken by BNZIS which would permit an offer of the Shares, or possession or distribution of any offering material, in any other country or jurisdiction where action for that purpose is required (other than New Zealand). The Shares may only be offered for sale or sold in conformity with all applicable laws and regulations in any jurisdiction in which they are offered, sold or delivered. No person may purchase, offer, sell, distribute or deliver any Shares, or have in its possession, publish, deliver or distribute to any person, any offering material or any documents in connection with the Shares, in any jurisdiction other than in compliance with all applicable laws and regulations.

Unless otherwise agreed with BNZIS, any person or entity applying for Shares is deemed to represent that they are not in a jurisdiction which prohibits the making of an offer of this kind and are not acting for a person in such a jurisdiction.

13 The public offer was of up to 350,000,000 BNZIS Shares at an issue price of $1 per share, with the right to accept over-subscriptions of a further $350,000,000. In total, 449,730,000 BNZIS Shares were issued pursuant to the offer, for a total subscription price of $449,730,000. Of these shares, 5,000 (the minimum parcel) have been subscribed for and are held by NEL.

14 The offer of the BNZIS Shares to the public in New Zealand closed on 25 March 2008. The issue date of the BNZIS Shares was 28 March 2008, and the date of initial quotation and trading on the debt securities market (the "NZDX") operated by New Zealand Exchange Limited ("NZX") was 31 March 2008. Although the BNZIS Shares are not debt securities for the purposes of the Securities Act 1978, the NZX has given certain rulings on, and waivers of, the Listing Rules in relation to the listing of the BNZIS Shares on the NZDX. The BNZIS Shares are freely transferable, subject to certain ownership limitations.

15 The BNZIS Shares are perpetual, non-cumulative shares and have no fixed term, although the commercial expectation is that the funding raised by means of the issue of the BNZIS Shares will be in place for an initial five-year period, with extensions of further five-year periods, if desired. This is subject to potential exercise of the call option referred to in paragraph 45. The BNZIS Shares are not redeemable at the option of BNZIS or the BNZIS Shareholders, and in no circumstances will there be any conversion of the BNZIS Shares to ordinary shares.

16 The BNZIS Shares are non-voting shares, other than in respect of amendments that relate to the rights, privileges, limitations and conditions attaching to them, meetings convened in relation to BNZIS's liquidation in certain circumstances and certain proceedings under the Security Trust Deed and the BNZIS Deed Poll (clause 6.22 of the BNZIS Constitution).

17 The BNZIS Shares (under clause 6.1 of the BNZIS Constitution) give BNZIS Shareholders the right to a quarterly dividend that is equal to a fixed percentage of the issue price per annum for the first five years as determined in accordance with the following formula:

$$\frac{\text{issue price} \times \text{dividend rate} \times (1\text{-t})}{4}$$

18 The elements referred to in the formula in paragraph 17 are as set out below.

(a) The issue price is $1.

(b) The dividend rate is the aggregate of the five-year swap rate (adjusted, as necessary, to a quarterly rate) and the margin (being 2.20%).

(c) "t" is:

(i) for the period to the first dividend payment date (on 28 June 2008), 30%, and

(ii) otherwise, the weighted average basic rate of New Zealand income tax applicable to BNZIS during the period ending on the relevant quarterly dividend payment date.

19 At the expiry of the first five-year period, there will be a further five-year rate set by reference to the then applicable five-year swap rate, such rate setting to take place two business days before that expiry date (but with no change to the margin). The same process will apply at the end of the second and subsequent five-year periods.

20 On liquidation, the BNZIS Shares give the right to a pro rata share of any surplus after liquidation of BNZIS's assets and payment of its debts, in priority and to the exclusion of the holders of other classes of shares of BNZIS other than shares expressed to rank equally in liquidation of BNZIS.

21 The Prospectus states:

> Cash to pay dividends on the Shares will be derived by BNZIS from interest it receives on its loan to BNZIM.

22 Payment of dividends on the BNZIS Shares will not occur if a Dividend Payment Condition occurs. Clause 6.5 of the BNZIS Constitution defines Dividend Payment Condition as any of the following conditions:

> (a) the Directors in their sole discretion do not resolve to pay the Dividend on the relevant Dividend Payment Date;
>
> (b) without limiting section 52(1) of the [Companies] Act [1993], the Directors are not satisfied on reasonable grounds that the Company will satisfy the solvency test (as defined in section 4 of the [Companies] Act [1993]) immediately after the payment of the Dividend;
>
> (c) unless APRA otherwise agrees:
>
> (i) after payment of the Dividend (which for the purposes of this calculation includes both the Dividend Amount in respect of the relevant Dividend and an amount equal to the Imputation Credits to be attached to the Dividend on the basis that the Dividend is Fully Credited), the APRA Prudential Capital Ratio or the APRA Tier 1 Capital Ratio of the NAB Group (on an APRA Level 2 or, if applicable, APRA Level 3 basis) would cease to comply with APRA's then current capital adequacy guidelines, as they are applied to the NAB Group at the time; or
>
> (ii) the amount of the Dividend (which for the purposes of this calculation includes both the Dividend Amount in respect of the relevant Dividend and an amount equal to the Imputation Credits to be attached to the Dividend on the basis that the Dividend is Fully Credited) would exceed the Distributable Profits of the NAB Group as at the relevant Dividend Payment Date; or
>
> (d) APRA otherwise objects to the payment of the Dividend by the Company.

23 Dividends paid on the BNZIS Shares will not be cumulative, and holders of the BNZIS Shares have no right to put BNZIS into liquidation for their non-payment (clause 6.6 of the BNZIS Constitution).

24 Many of the above features of the BNZIS Shares are required to ensure APRA treats the BNZIS Shares as innovative residual tier 1 capital for the NAB Group on a level 2 basis.

25 It is intended that the dividends will be fully imputed to the holders of the BNZIS Shares. Under the BNZIS Deed Poll, BNZIS covenants that, if it fails to fully impute dividends paid to the holders, it will compensate the holders for the additional tax cost incurred by the holders as a result of that failure. Clause 2 of the BNZIS Deed Poll states:

> **COVENANT TO PAY**
>
> BNZIS irrevocably covenants and agrees in favour of each Holder that, if BNZIS fails to attach sufficient Imputation Credits to any Dividend it pays on a Dividend Payment Date so that the Dividend is Fully Credited, then, subject to clause 3, it will pay to each Holder, within 10 Business Days of its receipt of the Holder's certificate, the amount that the Holder certifies in writing is necessary to compensate the Holder, on an after tax basis, for any additional tax cost the Holder suffers or incurs (or will suffer or incur) as a result of that failure, other than tax withheld by the Holder from a payment to another person.

BNZIM Loan

Details of the BNZIM Loan

26 BNZIS used the proceeds of the issue of the BNZIS Shares to make the BNZIM Loan to BNZIM. BNZIM is a company incorporated in New Zealand on 11 February 2008. BNZIM is expected to be resident for tax purposes in New Zealand. All of the shares in BNZIM are held by National Australia Group (NZ) Limited ("NAGNZ"), also a company incorporated in and tax resident in New Zealand. NAGNZ is the immediate holding company of BNZ and holds all of the ordinary shares issued in BNZ.

27 The BNZIM Loan is a perpetual loan (ie, it has no fixed maturity date). The principal amount of the BNZIM Loan is equal to the subscription amount for the BNZIS Shares. The BNZIM Loan is the only material asset of BNZIS and at least 90 percent of the income BNZIS derives will be interest from the BNZIM Loan.

28 Clause 4 of the BNZIM Loan Agreement provides that the BNZIM Loan pays interest quarterly. Interest is calculated in accordance with the following formula as defined in clause 1.1 of the Loan Agreement:

$$\frac{\text{loan amount} \times \text{interest rate}}{4}$$

29 The interest rate is the aggregate of the five-year swap rate (adjusted, as necessary, to a quarterly rate) plus the margin (being 2.20%).

30 At the expiry of the first five-year period, there will be a further five-year rate set by reference to the then applicable five-year swap rate, such rate setting to take place two business days before that expiry date (but with no change to the margin). The same process will apply at the end of the second and subsequent five-year periods.

31 The terms of the BNZIM Loan also oblige BNZIM to pay ongoing expenses incurred by BNZIS (such as expenses for services provided to it by BNZ or its auditors, and any net interest on short-term funding arrangements between it and BNZ).

32 Under clause 4.3 of the BNZIM Loan Agreement, interest on the BNZIM Loan will not be payable in respect of a quarterly interest period if an Interest Payment Condition applies. These conditions are if:

- payment of the corresponding dividend by BNZIS would breach certain APRA requirements or exceed the NAB Group's distributable profits;
- the payment of the interest would result in BNZIM failing to satisfy the solvency test under the Companies Act 1993;
- the directors of BNZIS would not be satisfied on reasonable grounds that BNZIS would satisfy the solvency test under the Companies Act 1993 immediately on payment of the corresponding dividend by BNZIS; or
- APRA otherwise objects to BNZIS making the corresponding dividend payment.

33 If and to the extent that all or any part of any interest on the BNZIM Loan is not paid because any of the above Interest Payment Conditions apply, BNZIM shall have no obligation to pay interesting respect of the relevant interest period and BNZIS's right to such amount will be cancelled.

34 As with the dividends on the BNZIS Shares, interest on the BNZIM Loan is not cumulative.

35 BNZIM invested the proceeds of the BNZIM Loan in BNZ Preference Shares (see paragraph 42). Because dividends on the BNZ Preference Shares will be paid on an after-tax basis, BNZIM will have a cash shortfall and will require additional funds to meet the interest payments on the BNZIM Loan. It is proposed that this cash shortfall be funded primarily by way of BNZ (or other profit-making companies in the BNZ group) making cash payments to BNZIM in exchange for loss-offset elections.

Repayment of BNZIM Loan

36 The BNZIM Loan is repayable at the option of BNZIM at any time on or after five years from the anniversary of the BNZIM Loan, or following the occurrence of a Regulatory Event, a Loan Repayment Event, the Call (see paragraph 45), or a Tax Event (clause 6.1 of the BNZIM Loan Agreement).

37 BNZIM must repay the BNZIM Loan in whole following the redemption, buy back, or acquisition of BNZ Preference Shares. In this regard, clause 6.2 of the BNZIM Loan Agreement states:

> The Borrower shall repay the Loan (in whole but not in part) together with any unpaid interest (accrued since the last Interest Payment Date) calculated at the applicable Interest Rate on the number of days elapsed since the last Interest Payment Date and on the basis of a 365 day year, immediately following the redemption, buy back or acquisition of the BNZ PPS.

38 Following the occurrence of a Transfer Event (as described in paragraph 39), BNZIM will repay the BNZIM Loan by transferring the BNZ Preference Shares to BNZIS. Such transfer will be deemed to be in full satisfaction of BNZIM's obligations under the BNZIM Loan Agreement.

39 Transfer Events are defined in clause 1.1 of the BNZIM Loan Agreement:

> *Transfer Event* means the occurrence of an APRA Event, a Liquidation Event, a Distribution Non-Payment Event or a BNZ Distribution Event.

Broadly, the Transfer Events comprise:

- NAB failing to meet certain APRA requirements or being subject to the Australian equivalent of statutory management
- non-payment of interest where the conditions to payment of interest under the BNZIM Loan have been satisfied
- BNZIS, BNZIM, or BNZ going into liquidation or statutory management, and
- BNZ paying an ordinary dividend when it has not paid dividends on the BNZ Preference Shares.

40 BNZIS's rights under the BNZIM Loan are limited in recourse to the BNZ Preference Shares, distributions on those BNZ Preference Shares or the proceeds of their sale (clause 10 of the BNZIM Loan and the definition of "Collateral" in clause 3.1 of the Security Trust Deed). BNZIS does not have recourse to any other assets of BNZIM.

41 BNZIM's obligation to transfer the BNZ Preference Shares to BNZIS is secured by a security interest over the BNZ Preference Shares in favour of the trustee under the Security Trust Deed.

BNZ Preference Shares

42 BNZIM invested the funds raised from the BNZIM Loan in subscription for the BNZ Preference Shares. These shares:

- on a liquidation of BNZ, rank in priority to ordinary shares issued by BNZ and have a right to receive an amount equal to their issue price plus the dividend accrued from the last dividend payment date (clause 25.9 of the BNZ Constitution)
- are non-voting shares, except as to certain matters such as matters affecting their rights, privileges, or limitations (clause 25.10 of the BNZ Constitution)
- pay a dividend on generally the same basis as the BNZIS Shares pay a dividend (but including the condition that directors of BNZ must be satisfied that payment of the dividend will not cause BNZ's capital ratios to cease complying with Reserve Bank of New Zealand's then current capital adequacy requirements) (clause 25.5 of the BNZ Constitution), and
- have a right to such dividend in priority to the payment of dividends on the ordinary shares issued by BNZ (clause 25.2 of the BNZ Constitution).

43 If a dividend is not paid on the BNZ Preference Shares on a dividend payment date, BNZ is not permitted to declare or make any distributions or payments on, or with respect to, any other shares in the capital of BNZ that rank equally with or junior to the BNZ Preference Shares (other than pro rata payments or distributions on shares that rank equally with the BNZ Preference Shares) unless and until:

- BNZ has paid dividends in full on the BNZ Preference Shares on two consecutive dividend payment dates immediately following that dividend payment date, or
- the call over the BNZIS Shares is exercised and the BNZIS Shares have been transferred in accordance with the terms of the call.

44 BNZ used the funds obtained by way of the issue of the BNZ Preference Shares for general business purposes, which may have included using them to repatriate funds back to the NAB Group in Australia. Any such repatriation may be by way of a dividend, a share or loan repayment, or another mechanism.

Termination: Call over BNZIS Shares

45 Under the terms of the BNZIS Shares, NAB is granted a call option ("the Call") over the BNZIS Shares, which it can exercise subject to its obtaining APRA's prior written approval. Clause 6.9 of the BNZIS Constitution states that NAB has this right in the following circumstances:

> (a) on the Initial Call Date (or on any Dividend Payment Date falling after that date, as specified in the Call Notice);
>
> (b) at any time following a redemption, buy back or acquisition of the BNZ PPS; or
>
> (c) at any time after the occurrence of a Regulatory Event, a Loan Repayment Event or a Tax Event.

46 The Call may be exercised before the fifth anniversary on the happening of certain events that, broadly speaking, diminish the benefits to the NAB Group of the BNZIS Shares being on issue. These are referred to as Regulatory Events and Tax Events. The Call may also be exercised if certain other structurally significant events affecting BNZIS or BNZIM occur, referred to as Loan Repayment Events, or the BNZ Preference Shares are redeemed, bought back or acquired.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) During the period of the Ruling, the BNZIS Shares will be listed on the NZDX or another "recognised exchange" as defined in section YA 1.

b) During the period of the Ruling, BNZIS is not treated under a double tax agreement as not being resident in New Zealand.

c) During the period of the Ruling, ordinary shares in BNZIS will only be held by a person who also holds BNZIS Shares.

d) During the period of the Ruling, each holder of a BNZIS Share has rights in relation to all the proceeds from the BNZIM Loan.

e) During the period of the Ruling, BNZIS will be an "ICA company" as defined in section YA 1.

f) During the period of the Ruling, any distributions made by BNZIS in respect of the BNZIS Shares will be fully credited for the purposes of section CD 43(26) of the Act to the extent permitted by the imputation credits that the directors of BNZIS determine are available.

g) During the period of the Ruling, income derived by BNZIS will to the extent of 90 percent or more be derived from interest it receives on its loan to BNZIM.

h) During the period of the Ruling, BNZIS will not cancel the election it has made to be a PIE under section HL 11.

i) During the period of the Ruling, the Constitution of BNZIS will not be materially altered or amended from the version provided to Inland Revenue on 11 April 2008 (as part of the application for a binding ruling) in a manner that relates to the eligibility requirements to be a PIE and a PLC set out in the Act.

How the Taxation Laws apply to the Arrangement

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

- A distribution in respect of the BNZIS Shares is "excluded income" under section CX 56(3) of a holder of the BNZIS Shares who is:
  - (i) A New Zealand resident who is a natural person or a trustee and who does not elect to include the amount of such distributions in that holder's return of income for the applicable year, and
  - (ii) A person not referred to in paragraph (i) above to the extent to which the amount of the distribution is not fully imputed as described in section RF 9(2).
- Section GB 35 does not apply to the Arrangement.
- Section BG 1 does not apply to vary or negate the above conclusions

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 28 March 2008 and ending on 28 March 2013.

This Ruling is signed by me on the 5th day of February 2009.

Howard Davis

Director (Taxpayer Rulings)

LEGISLATION AND DETERMINATIONS

This determination is fully described in product ruling BR PRD 09/02 on page 19.

DETERMINATION S14: ISSUE OF PERPETUAL NON-CUMULATIVE SHARES BY BNZIS AND RELATED TRANSACTIONS

This determination may be cited as "Determination S14: Issue of perpetual non-cumulative shares by BNZIS and related transactions.

1. Explanation

(which does not form part of the determination)

1 This determination relates to an arrangement involving the issue of perpetual non-cumulative shares (the "BNZIS Shares") by BNZ Income Securities Ltd ("BNZIS") to the public and National Equities Limited ("NEL") pursuant to an Investment Statement dated 25 February 2008. That arrangement is the subject of private ruling BR PRV 09/03 and product ruling BR PRD 09/02, issued on 5 February 2009, and is fully described in those rulings.

2 The BNZIS Shares are excepted financial arrangements. The BNZIS Shares form part of a wider financial arrangement including the investment by BNZIS of the proceeds of issue of the BNZIS Shares by way of a loan (the "BNZIM Loan") to BNZ Income Management Ltd ("BNZIM"), and the use of the BNZIM Loan proceeds by BNZIM to subscribe for perpetual preference shares issued by BNZ (the "BNZ Preference Shares"). The BNZIS Shares are also subject to a call option ("all Option") held by National Australia Bank Ltd ("NAB"). BNZIS has entered into a Deed Poll ("Deed Poll") in favour of the BNZIS Shareholders, which applies if the dividends on the BNZIS Shares are not fully imputed and this results in a loss to a BNZIS Shareholder.

3 This wider financial arrangement has "excepted financial arrangement" components as defined in section EW 5 of the Income Tax Act 2007. The excepted financial arrangements are:

- the BNZIS Shares
- the BNZ Preference Shares, and
- the Call Option.

4 The amount of gross income deemed to be derived, or expenditure deemed to be incurred, by a person under the financial arrangement rules in respect of a financial arrangement excludes any amount of income, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement.

5 This determination prescribes a method to be used for determining the part of the consideration receivable by the parties to the arrangement that is attributable to the excepted financial arrangements.

2. Reference

1 This determination is made pursuant to section 90AC(1)(h) of the Tax Administration Act 1994.

3. Scope of Determination

1 This determination applies specifically to:

- the BNZIS Shares
- the BNZ Preference Shares, and
- the Call Option.

4. Principle

1 The BNZIS Shares, the BNZ Preference Shares, the Call Option and the BNZIM Loan are each part of a wider financial arrangement which has "excepted financial arrangement" components as defined in section EW 5 of the Income Tax Act 2007. The excepted financial arrangements are:

- the BNZIS Shares
- the BNZ Preference Shares, and
- the Call Option.

2 Any income, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement is not included when calculating gross income or expenditure under the financial arrangement rules.

3 This determination specifies that the amounts that are solely attributable to the excepted financial arrangements are the amounts paid under or with respect to the BNZIS Shares, the BNZ Preference Shares and the Call Option.

4 This determination specifies that no part of (inter alia) the amount advanced or repaid under the BNZIM Loan, or the interest paid on the BNZIM Loan, is solely attributable to an excepted financial arrangement.

5. Interpretation

1 This determination has no specialised terms that need to be defined further.

6. Method

1. The amounts that are solely attributable to the BNZIS Shares are:
   - the issue price per BNZIS Share of $1
   - the dividends paid on the BNZIS Shares by BNZIS
   - any amount paid by BNZIS under the Deed Poll where BNZIS has not fully imputed the dividends on the BNZIS Shares
   - any other distributions paid on or with respect to the BNZIS Shares by BNZIS, and
   - any amounts paid to acquire the BNZIS Shares, whether pursuant to the Call Option or otherwise.
2. The amounts that are solely attributable to the BNZ Preference Shares are:
   - the issue price per BNZ Preference Share of $1
   - the dividends paid on the BNZ Preference Shares by BNZ
   - any other distributions paid on or with respect to the BNZ Preference Shares by BNZ, and
   - any amounts paid to acquire the BNZ Preference Shares.
3. The amounts that are solely attributable to the Call Option are:
   - the amount paid to acquire the BNZIS Shares under the Call Option, and
   - the value of the BNZIS Shares transferred to a person nominated by NAB pursuant to the Call Option.

7. Example

BNZIS raised $449,730,000 from the issue of the BNZIS Shares on 28 March 2008, and lent the same amount to BNZIM, at an interest rate of 9.89% per annum, payable quarterly on 28 March, June, September and December. Therefore, the amount of interest on the BNZIM Loan for each full quarter is $11,119,574.

BNZIM used the funds to invest in BNZ Preference Shares.

The BNZIS Shares have traded on the NZDX at prices of from $1 to $1.10.

The amounts solely attributable to an excepted financial arrangement are:

- the issue price of the BNZIS Shares
- the dividend paid on the BNZIS Shares
- the consideration paid for the purchase of BNZIS Shares on the NZDX
- the issue price of the BNZ Preference Shares, and
- the dividend paid on the BNZ Preference Shares.

The amounts not solely attributable to an excepted financial arrangement are:

- the amount of the BNZIM Loan ($449,730,000)
- the interest paid on the BNZIM Loan ($11,119,574 per quarter)
- the amount paid by BNZIM to BNZIS under the BNZIM Loan as reimbursement for expenses incurred by BNZIS (provided that such expenses are not "non-integral fees", as defined in section YA 1), and
- the amount to be repaid on the repayment of the BNZIM Loan.

This determination is signed by me on the 5th day of February 2009.

Howard Davis
Director (Taxpayer Rulings)

LIVESTOCK VALUES – 2009 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs (NSC) for specified livestock for the 2008–2009 income year.

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

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

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

For bobby calves, information from spring 2008 is used while other dairy NSCs are based on survey data for the year ended 30 June 2008. For sheep, beef cattle, deer and goats, NSC are based on survey data for the year ended 30 June 2007 which is the most recently available data for those livestock types at the time the NSCs are calculated in December 2008.

For the 2008–2009 income year there has been a significant increase (in dollar terms) for all livestock types. For sheep and beef the increase generally reflects the high level of increase in input prices. The rise in 1-year dairy cattle costs is due, in the main, to an increase in farm expenses, particularly feed and animal health. The rising 2-year class increases were also due to higher input costs and a higher portion of growing stock relative to cows in milk during the survey year.

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

The NSC values for the other livestock types (deer, meat and fibre goats, dairy goats and pigs) also increased for reasons similar to those expressed above.

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

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

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

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2009

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2009".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2008–2009 income year where the taxpayer has elected to value that livestock under the national standard costs (NSC) scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007 the national standard costs for specified livestock for the 2008-2009 income year are as set out in the following table.

Kind of livestock	Category of livestock	National standard cost
Sheep	Rising 1 year	$26.00
	Rising 2 year	$17.80
Dairy Cattle	Purchased bobby calves	$176.90
	Rising 1 year	$787.60
	Rising 2 year	$142.60
Beef Cattle	Rising 1 year	$261.60
	Rising 2 year	$150.00
	Rising 3 year male non-breeding cattle (all breeds)	$150.00
Deer	Rising 1 year	$91.80
	Rising 2 year	$44.50
Goats (Meat and Fibre)	Rising 1 year	$20.90
	Rising 2 year	$14.30
Goats (Dairy)	Rising 1 year	$155.50
	Rising 2 year	$25.20
Pigs	Weaners to 10 weeks of age	$93.10
	Growing pigs 10 to 17 weeks of age	$75.20

This determination is signed by me on the 29th day of January 2009.

Susan Price
Director, Public Rulings

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 (URGENT MEASURES AND ANNUAL RATES) ACT 2008

The Taxation (Urgent Measures and Annual Rates) Bill 2008 was introduced into Parliament on 9 December 2008 and passed under urgency on 11 December 2008. The resulting Act received Royal assent on 15 December 2008.

The new legislation introduces changes to personal income tax rates and KiwiSaver, introduces an independent earner tax credit and repeals the research and development tax credit. The legislation gives effect to measures foreshadowed by the new government in its 2008 general election campaign. The legislation also confirms the annual rates for the 2009–10 tax year.

The changes take effect from 1 April 2009.

The new Act amends the Income Tax Act 2007, the Tax Administration Act 1994, the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008, the Taxation (Business Taxation and Remedial Matters) Act 2007, the KiwiSaver Act 2006 and the KiwiSaver Regulations 2006.

TAX CUTS FOR INDIVIDUALS

Sections LC 13, RD 17(2), RD 58(1), RD 59(3), RD 60(3)(a), RD 61(3)(a), RE 12(3)(a), RE 12(4), RZ 5B, RZ 5C, YA 1, schedule 1, parts A, C and D, and schedule 2, parts A and B of the Income Tax Act 2007

Sections 3(1), 24B(3)(a), (ab), (c) and (d), 33A(1)(b)(iv)(A), 33A(1)(b)(iv)(AA), 33A(1)(b)(iv)(BA), 33A(1)(b)(v)(A), 33A(1)(b)(v)(AA), 33A(1)()(v)(BA), 33A(1)(b)(vi)(A), 33A(1)(b)(vi)(AA), 33A(1)(b)(vi)(BA), 33A(1)(b)(vib), 33A(2)(db), 43A(2)(d)(iib), 108(1B)(b) and 177C(1B) of the Tax Administration Act 1994

Sections 7(2) to (4), 8(2) to (4), 10(2) to (4), 11(3) and (4), 13(2) and (3), 14(2) and (3), 15(2) and (3), 16(2) and (3), 18(2) and (3) of the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008

Reductions to personal income tax rates are to be phased in over three years, beginning 1 April 2009. These changes are in addition to the tax cuts that came into effect on 1 October 2008. The package has two key elements:

- changes to personal income tax rates and thresholds, and
- the introduction of an independent earner tax credit (IETC).

Key features

The Income Tax Act 2007 and the Tax Administration Act 1994 have been amended to provide tax cuts for individuals. The main features are:

- The changes will be rolled out progressively in three stages from 1 April 2009.
- As well as changes to thresholds at which personal tax rates apply, the 21% rate will drop to 20% from 1 April 2011, and the 39% rate will drop to 38% from 1 April 2009, and again to 37% from 1 April 2010.
- The introduction of the independent earner tax credit (IETC). This will be available to individuals who earn $24,000 and over, at a maximum yearly amount of $520 from 1 April 2009, and $780 from 1 April 2010. It is abated at 13 cents for every dollar of income earned over $44,000.
- Banks and other financial institutions will be able to apply a new optional 38% resident withholding tax (RWT) rate from 1 April 2009.
- A number of consequential changes have been made to parts of the tax system affected by the changes to personal tax rates. These include fringe benefit tax rates, the employer superannuation contribution tax and thresholds for extra pay and secondary tax codes.

Application dates

The personal income tax cuts will be phased in over three years, starting on 1 April 2009, with further cuts starting on 1 April 2010. The final cuts will begin on 1 April 2011.

Detailed analysis

Personal tax rate reductions

Under the previous legislation, the following tax rates applied to personal income from 1 October 2008:

$0 – $14,000	12.5%
$14,001 – $40,000	21%
$40,001 – $70,000	33%
$70,001 and over	39%

Following enactment of the Taxation (Urgent Measures and Annual Rates) Act 2008, the following personal tax rates will apply (changes bolded for emphasis):

From 1 April 2009

$0 – $14,000	12.5%
$14,001 – **$48,000**	21%
$48,001 – $70,000	33%
$70,001 and over	**38%**

From 1 April 2010

$0 – $14,000	12.5%
$14,001 – **$50,000**	21%
$50,001 – $70,000	33%
$70,001 and over	**37%**

From 1 April 2011

$0 – $14,000	12.5%
$14,001 – **$50,000**	**20%**
$50,001 – $70,000	33%
$70,001 and over	37%

Salary and wage earners will receive the tax cut through a reduction in the PAYE tax their employers withhold on their regular pay. Self-employed and other non-salary and wage earners will receive the tax cut when they file a tax return or request a personal tax summary at the end of the tax year.

Consequential changes to other parts of the tax system

To ensure that the changes to the personal tax rates and thresholds flow through the tax system correctly, a number of changes to other parts of the tax system have been made. These include fringe benefit tax rates, the employer superannuation contribution tax and thresholds for extra pay and secondary tax codes.

No immediate changes have been made to the tax rate structure that applies to portfolio investment entities (PIEs) to reflect the new personal tax rate structure. The government has indicated that the associated changes to the PIE tax rates will be considered after further consultation with the managed funds industry, with any changes likely to apply from 1 April 2010.

Similarly, the government has indicated that the necessary changes to the resident withholding tax (RWT) rates on interest will not be fully implemented until there has been further consultation with banks and other financial institutions. However, banks and other financial institutions will be able to apply a new optional 38% RWT rate from 1 April 2009. The government has indicated that it is likely that changes to the RWT rate structure to fully reflect the new personal tax rate structure will apply from 1 April 2010.

Independent earner tax credit (IETC)

The independent earner tax credit (IETC) is a credit for middle-income taxpayers who do not receive core assistance from the government.

To be eligible for the IETC, a person must earn $24,000 and over and must not receive a benefit, Working for Families tax credits or New Zealand superannuation. The IETC is available to New Zealand tax residents only.

The maximum yearly amount of the credit is $520 from 1 April 2009, and $780 from 1 April 2010. The IETC is abated at 13 cents for every dollar of income earned over $44,000.

Salary and wage earners can receive the IETC regularly in their pay packets by electing a new tax code with their employer. The new code is "ME".

Self-employed and other non-salary and wage earners can receive the IETC when they file their tax return or when requesting a personal tax summary at the end of the tax year.

People who already receive specified types of government assistance such as benefits, Working for Families tax credits, New Zealand superannuation, veterans' pension, or foreign pensions and benefits will not be eligible for the IETC.

Benefits

People who receive the following benefits are not eligible for the IETC:

- domestic purposes benefit
- emergency benefit
- independent youth benefit
- invalids' benefit
- sickness benefit
- unemployment benefit
- widows' benefit.

Working for Families tax credits

People who receive Working for Families tax credits are not eligible for the IETC.

If a person's spouse or partner receives Working for Families tax credits, the person will not be eligible for the IETC. This is because the Working for Families scheme is a family-based entitlement.

New Zealand superannuation and veterans' pension

Individuals who receive New Zealand superannuation and the veterans' pension are not eligible for the IETC.

Foreign pensions and benefits

Individuals who receive pensions and benefits paid by overseas governments that are similar in nature to New Zealand superannuation, the veterans' pension, Working for Families tax credits or income-tested benefits will also not be eligible for the IETC. Whether the foreign income is exempt under New Zealand or foreign law is not relevant to the question of whether it is of a similar nature to one of the income categories listed above.

This ensures that people who are receiving income assistance from the New Zealand government and those receiving assistance from overseas governments are treated equally.

Benefits that don't affect IETC eligibility

People who receive student allowances, ACC payments, paid parental leave or the accommodation supplement will be eligible for the IETC if they meet the other eligibility criteria.

Part-year entitlement to the IETC

The IETC will be pro-rated for people who receive a benefit, pension or Working for Families tax credits, or who were non-resident for tax purposes, for only part of an income year. The amount of IETC is based on the number of whole months that the person is resident in New Zealand and does not receive a disqualifying payment.

Example 1: Receiving an unemployment benefit for part of the year

Andrew receives the unemployment benefit, which is a disqualifying payment. On 15 May 2009, Andrew starts a new job as a carpenter. During the 2009–10 income year, Andrew earns $30,000 and receives no other disqualifying payments apart from the unemployment benefit that he received during April and May.

Andrew is eligible for the IETC as he earns over $24,000. Because he earns under $44,000, the abatement of 13 cents in the dollar does not apply. However, his IETC is proportionally reduced for the two months – April and May – that he received the unemployment benefit.

The amount of IETC that he is entitled to is calculated as follows:

(IETC – abatement) x credit period months / 12

"Credit period months" is the number of whole months during which the person receives no disqualifying payments and was resident in New Zealand. Andrew received no disqualifying payments during the months from June 2009 to March 2010. The number of whole months during which Andrew receives no disqualifying payments is therefore 10.

Andrew's IETC is calculated as follows:

($520 – $0) x 10 / 12 = $433.33

Example 2: Resident in New Zealand for part of the year

During the 2009–10 income year, Amy earns $45,000 and does not receive any disqualifying payments. She is therefore eligible to receive the IETC. As she earns over $44,000, her IETC is abated at 13 cents in the dollar.

She is resident in New Zealand for tax purposes between 1 April 2009 and 22 January 2010. On 22 January, she leaves New Zealand to move permanently to the United Kingdom. As she is not tax-resident in New Zealand from 23 January, she is not entitled to the IETC for the months of January, February and March.

Amy's IETC is calculated as follows:

($520 – $130) x 9 / 12 = $292.50

REPEAL OF RESEARCH AND DEVELOPMENT TAX CREDIT

Sections LH 1 to 6, LH 8 to LH 16, YA 1, YB 20(2) and schedule 21 of the Income Tax Act 2007; sections 3(1), 33A(2), 43A(2), 91AAP and 108(1B) of the Tax Administration Act 1994

The research and development tax credit has been repealed, effective from the 2009–10 income year. The tax credit remains in place for the 2008–09 income year.

Background

A 15% tax credit for eligible expenditure on R&D activities was introduced in 2007, with effect from the 2008–09 income year.

The subsequent repeal of the tax credit was foreshadowed in the 2008 general election campaign. As the explanatory note of the Taxation (Urgent Measures and Annual Rates) Bill explained:

> … The Government's objective in repealing the tax credit is to move towards a broad-based, low-rate tax system, which will improve the quality of investment and reduce distortions.

Removing the R&D tax credit will also partially fund the reduction in personal tax rates. The Government considers the benefits of reducing tax rates are certain, whereas the benefits of the R&D tax credit are less certain.

The Government is concerned that much of the credit will fund R&D that would have occurred in any case, the compliance costs associated with claiming the credit are high and that the credit will be paid out on standard operating expenditure re-characterised as R&D-related expenditure.

Key features

Main repeal (sections LH 1 to LH 6, LH 8 to LH 14, LH 16, YA 1, YB 20(2)(ob) and schedule 21 of the Income Tax Act 2007)

The provisions that determine eligibility and calculate the value of the R&D tax credit have been repealed from the 2009–10 income year.

Expenditure on activities that take place in the 2009–10 or subsequent income years will not be eligible for the tax credit.

Example 1: Effect on research and development projects

F Co starts a two-year R&D venture in the 2008–09 income year that includes activities that meet the definition of eligible R&D activities in each year. The eligible expenditure and depreciation loss totals $350,000 in the 2008–09 income year. In that year, F Co incurs expenditure of $100,000 on activities carried out in New Zealand and $250,000 on activities carried out in Australia. The activities continue into the 2009–10 income year, and the firm incurs $300,000 of expenditure on activities carried out in New Zealand that would have been eligible for the tax credit had the credit not been repealed.

F Co can claim the R&D tax credit for the eligible New Zealand expenditure and depreciation loss for the 2008–09 income year, but not for any portion of the overseas expenditure or depreciation loss for that year (since more than half of the eligible expenditure or depreciation loss must be incurred in New Zealand). Expenditure in the 2009–10 income year is no longer eligible for a tax credit.

Consequential amendments repeal schedule 21 and the definitions of "district health board", "industry research co-operative", "listed research provider", "overseas eligible expenditure", "research and development project" and "tertiary institution" from section YA 1. For simplicity, the repeal date of the schedule and these definitions are aligned with the last possible date of the 2008–09 income year.

Deferred or carried-forward expenditure (sections LH 2 and LH 6(5) of the Income Tax Act 2007)

Expenditure on activities carried out in the 2008–09 income year that would have been eligible for a tax credit only in a subsequent year will no longer be eligible.

This means that an adjustment made in the 2008–09 income year under section DB 50 of the Income Tax Act 2007 for unpaid expenditure on employment income will not be eligible when the deferred income is paid out in a subsequent period. Similarly, overseas eligible expenditure that has to be carried forward from the 2008–09 income year because the claimant has insufficient local expenditure on the same R&D project in that year will no longer be eligible for the tax credit.

NEW LEGISLATION

Example 2: Eligible overseas expenditure
A New Zealand company, G Co, incurs eligible expenditure of $1 million on R&D activities carried out in New Zealand in the 2008–09 income year. In the same year, it also incurs eligible expenditure of $400,000 on R&D conducted overseas on the same R&D project.

In the following year, it incurs expenditure of $500,000 on activities carried out in New Zealand that would have been part of the same R&D project and that would have been eligible for a tax credit had the tax credit not been repealed.

G Co can claim the R&D tax credit for the local expenditure in the 2008–09 income year and on any overseas expenditure incurred that year, up to the value of 10 percent of the New Zealand eligible amount, which in this case is $100,000. The other $300,000 of overseas expenditure is not eligible for a tax credit in the 2008–09 income year or in subsequent years.

Listed research providers (section LH 15 of the Income Tax Act 2007)

The provisions that relate to a listed research provider (LRP) will be repealed from 1 October 2009. That will allow claimants, including those with late balance dates, to use the exception to the minimum threshold for eligible expenditure paid to a non-associated LRP.

Administration (sections 3(1), 33A(2), 43A(2), 91AAP and 108(IB) of the Tax Administration Act 1994)

As a result of the main repeal of the R&D tax credit, provisions no longer necessary to administer the tax credit have been repealed. The definition of "response period" in section 3(1) has been amended because the time periods that relate to claims for the 2010–11 and subsequent income years are no longer necessary. A similar amendment has been made to section 108(1B). Sections 33A(2)(db) and 43A(2)(d)(iib) have been repealed from the 2009–10 income year. Section 91AAP is repealed from the date that the provision was initially enacted.

A number of administrative and definition provisions have been retained so that the tax credit can continue to be administered for the 2008–09 income year.

Application date

Repeal of the R&D tax credit is effective from the 2009–10 income year.

KIWISAVER

Sections 64, 65, 66, 66A, 101B, 101D, 235 and schedule 4 of the KiwiSaver Act 2006; sections DC 7, MK 1, MK 9 to 14, RD 65, YA 1 and schedule 28 of the Income Tax Act 2007 and Regulation 20 of the KiwiSaver Regulations 2006; sections 2(1), 4(b), 8, 9 and 10 of the Employment Relations Amendment Act 2008

The new legislation gives effect to a number of changes to the KiwiSaver scheme that were foreshadowed by the new government in its 2008 general election campaign.

Key features and application dates

The new rules for KiwiSaver and complying superannuation funds involve amendments to the KiwiSaver Act 2006, the Income Tax Act 2007, the KiwiSaver Regulations 2006 and the Employment Relations Act 2000. The changes are:

- The minimum employee contribution rate will be reduced to two percent of gross salary or wages from 1 April 2009.
- The compulsory employer contribution will be capped at two percent of the employee's gross salary or wages from 1 April 2009. (Increases in the compulsory employer contribution rate to three and four percent in section 101D(4) of the KiwiSaver Act have been removed.)
- The employer tax credit paid to employers to offset some of the costs associated with compulsory employer contributions will be discontinued from 1 April 2009.
- The exemption from employer superannuation contribution tax will be capped at the employer's minimum compulsory contribution rate of two percent from 1 April 2009.
- The fee subsidy of $40 a year paid to member's KiwiSaver accounts to offset some of the fees charged by providers will be discontinued from 1 April 2009.
- Sections 103(1)(h) and 110A of the Employment Relations Act, and section 101B(5)(b) of the KiwiSaver Act have been repealed. These provisions would have allowed an employee to bring a personal grievance if the employee was treated on a different basis as a result of being a KiwiSaver member or a complying superannuation fund member. The repeal is effective from 16 December 2008, the day after the Taxation (Urgent Measures and Annual Rates) Act 2008 received assent.
- Section 101B of the KiwiSaver Act now requires compulsory employer contributions to be paid in addition to an employee's gross salary or wages if the employee joins KiwiSaver. This rule will also apply

if a KiwiSaver member starts new employment. Employers and employees may contract out of this requirement through good faith bargaining as part of the employment relationship. This provision applies from 15 December, the date on which the Taxation (Urgent Measures and Annual Rates) Act received Royal assent.

- New section 235 of the KiwiSaver Act provides protection against any non-compliance with securities-related legislation that may result from the enactment of the Taxation (Urgent Measures and Annual Rates) Act. In particular, this provision:
  - Allows a general exemption from compliance with an Act related to securities for a limited period from 15 December 2008 to 14 February 2009. This period allows providers to update prospectuses and register them with the Registrar of the Companies Office. It also allows them time to update and reprint investment statements or draft a statement of the changes as a result of legislative changes that will be included in an existing investment statement.
  - Allows an exemption from complying with regulation 7A(4) of the Securities Regulations 1983 for a limited period from 15 December 2008 to 30 June 2009. The effect of this exemption is that providers can insert a statement of the changes resulting from this legislation in an existing investment statement. It will apply to an investment statement that is first prepared and dated before 1 January 2009.

Detailed analysis

Employee contribution rate reduced

Sections 64, 65, 66 and 66A of the KiwiSaver Act have been amended to give effect to the new minimum employee contribution rate of two percent. Employees who are existing members before 1 April 2009 will continue to use their existing contribution rate as at 31 March 2009 of two percent, four percent or eight percent. For example, employees whose contribution rate is two percent under transitional rules provided by section 66A will continue to use that rate until they notify their employer under section 64(2) that they want to use a new rate.

For employees who join KiwiSaver from 1 April 2009 or existing members who begin new employment from that date, the new minimum contribution rate of two percent will be the default rate unless the employee requests to use a higher rate. For example, an existing KiwiSaver member starts new employment on 1 June 2009. Unless that member notifies the new employer of a contribution rate, the minimum contribution rate of two percent will apply.

The employee can notify the employer that either the four percent or the eight percent rate should apply.

Under current law, employees can only change their contribution rate at intervals of three months or more unless their employer agrees otherwise.

For complying superannuation funds, item 7 of schedule 28 of the Income Tax Act 2007 has been amended to reflect the new minimum contribution rate of two percent.

Employer tax credit discontinued

Sections DC 7(1B), MK 1(2) and (4), and MK 9 to MK 14 of the Income Tax Act are repealed from 1 April 2009. The repeal of section DC 7(1B) removes the limitation on the amount that an employer can claim as a tax deduction for employer contributions to a KiwiSaver scheme or a complying superannuation fund.

The effect of the repeal of sections MK 1(2) and (4), and MK 9 to 14 is that employers are not able to claim an employer tax credit for employer contributions made on or after 1 April 2009. As the employer tax credit was calculated on a payment period in which PAYE is withheld in relation to an employee, the employer tax credit cannot be claimed for any pay period which ends on or after 1 April 2009. This is because the employer contribution payable in respect of the employee's contribution will occur at the same time as the employer deduction is made. Employers are able to claim a credit for employer contributions made in respect of employee contributions deducted in the year to 31 March 2009.

Fee subsidy discontinued

Regulation 20 of the KiwiSaver Regulations 2006 has been amended so that the fee subsidy is discontinued from 1 April 2009. Individuals who join KiwiSaver from 1 April 2009 will not be entitled to the fee subsidy. Individuals who join KiwiSaver before 1 April 2009 will be entitled to receive the annual fee subsidy payable for the current year of membership. For example, if an individual is subject to the automatic enrolment rules on 1 February 2009 when the person started a new job and provided they do not opt out, the person will be treated as being a member from that date and will receive the annual fee subsidy of $40 in two instalments. The first instalment of $20 will be three months after Inland Revenue received the member's first contribution and the second will be six months later.

Compulsory employer contributions in addition to gross salary or wages

Section 101B of the KiwiSaver Act has been amended by replacing subsection (4) with new subsections (4) and (4A). The previous section required compulsory employer contributions to be paid in addition to the employee's gross salary or wages.

Subsection (4) provides that from 13 December 2007, an employee and employer are free to agree contractual terms that override the requirement to pay compulsory employer contributions in addition to gross salary or wages. The duty of good faith applies to these employment relationship negotiations. However, this requirement cannot be overridden after 15 December 2008[1] if an employee becomes entitled to compulsory employer contributions as a result of becoming a new member or if an existing member starts new employment and the contractual terms and conditions do not account for the amount of compulsory employer contributions the employer is required to pay. In this case, new subsection 4A makes it clear that the compulsory employer contribution must be in addition to the gross salary or wages.

Example 1

Jo starts new employment on 1 April 2009. She is not a member of KiwiSaver and is subject to the automatic enrolment rules. Unless Jo and her employer otherwise agree to the terms and conditions relating to compulsory employer contributions as part of their employment relationship, the compulsory employer contribution will be in addition to Jo's gross salary or wages. The duty of good faith always applies to the employment relationship negotiations.

Jo and her employer may agree as part of the negotiations that Jo will be paid a superannuation allowance equal to the amount of compulsory contributions and that allowance will be used to meet any employer obligation if Jo becomes a member.

This allowance will be used by the employer to meet compulsory employer contributions as Jo is subject to automatic enrolment. If Jo opts out, the refund of those contributions will need to be paid to Jo by her employer as it is part of Jo's total remuneration.

If Jo opts into KiwiSaver at some time in the future, the employer's obligations can be met from this allowance.

Example 2

Jo starts new employment on 1 April 2009 and is already a member of KiwiSaver. As part of starting new employment, Jo is required to inform her employer that she is a member of KiwiSaver and provide either her contribution rate or a valid contributions holiday notice. Unless Jo and her employer otherwise agree to the terms and conditions relating to compulsory employer contributions as part of their employment relationship, the compulsory employer contribution will be in addition to Jo's gross salary or wages. The duty of good faith will always apply to these employment relationship negotiations.

Jo and her employer may agree as part of their negotiations that she will be paid a superannuation allowance equal to the amount of her compulsory contribution and that allowance will be used to meet any employer obligations.

This allowance will be used by the employer to meet compulsory employer contributions as Jo is a member. If Jo takes a contributions holiday, the allowance must be paid as part of the remuneration package.

Example 3

Jo has been with the same employer since 1 April 2007 and has not joined KiwiSaver. On 1 April 2009, Jo provides her employer with a notice to have KiwiSaver deductions made (opt-in via employer). The compulsory employer contribution will be in addition to Jo's gross salary or wages as Jo and her employer have not agreed otherwise.

Example 4

Jo has been with the same employer since 1 April 2007 and has not joined KiwiSaver. On 1 April 2009, Jo provides her employer with a notice to have KiwiSaver deductions made (opt-in via employer). Unless Jo and her employer otherwise agree to the terms and conditions relating to compulsory employer contributions as part of their employment relationship, the compulsory employer contributions will be in addition to Jo's gross salary or wages.

On 1 April 2008, with the advent of employer compulsory employer contributions, the employer as part of good faith bargaining provides all employees with a superannuation allowance of 4 percent of gross salary or wages. The allowance is to be used to meet employer obligations if the employee joins KiwiSaver.

As Jo has agreed her contractual terms and conditions for compulsory employer contributions after 13 December 2007, the allowance can be used to meet her employer's obligations.

[1] This is the date of assent of the Taxation (Urgent Measures and Annual Rates) Act 2008.

ANNUAL INCOME TAX RATES FOR 2009–10

Schedule 1, part A of the Income Tax Act 2007

The income tax rates (based on whole dollars) that apply for the 2009–10 tax year are:

	Tax rate
Individuals: 0 – 14,000 14,001 – 48,000 48,001 – 70,000 70,001 upwards	 12.5% 21% 33% 38%
Taxable income: Companies	30%
Taxable income: Trustees	33%
Taxable distributions: Non-complying trusts	45%
Schedular taxable income: Category A income of group investment funds	30%
Taxable income: Trustees of certain funds (approved unit trusts, widely held group investment funds and widely held superannuation funds)	30%
Taxable income: Māori authorities	19.5%
Schedular taxable income: Policyholder income	30%

WORKING FOR FAMILIES OVERPAYMENTS

Section 177C(1B) and (1C) of the Tax Administration Act 1994

The May Budget 2008 brought forward inflation adjustments to Working for Families tax credits from 1 April 2009 to 1 October 2008. From 1 October, the weekly and fortnightly amounts of Working for Families tax credits paid out were increased to reflect the entire inflation indexation adjustment.

Final entitlements to Working for Families tax credits are calculated at the end of the year, however, and are based on the annual amount of the tax credit and the income abatement threshold. In the 2008–09 tax year the annual family tax credit and the abatement threshold are increased to reflect a composite amount; the average between the annual amount before 1 October 2008, and the annual amount after the 1 October 2008 inflation adjustment.

Families paid weekly or fortnightly and whose Working for Families tax credit entitlements changed part-way through the year (due to changes in their family circumstances, such as a child entering the family in the middle of the year) could therefore receive overpayments of Working for Families tax credits. The end-of-year entitlement based on the composite amount will be lower than the fortnightly or weekly amount received for recipients who, for example, have a new child after 1 October 2008. As a result, these overpayments could in turn result in tax bills for affected families at the end of the tax year.

The legislation has been amended to ensure that overpayments caused by the mid-year change to Working for Families tax credit entitlements are not required to be repaid. Working for Families overpayments of up to $100 are automatically written off for the 2008–09 income year.

Application date

The amendment applies from 1 April 2009.

LEGAL DECISIONS – CASE NOTES

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

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

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

COMMISSIONER'S RIGHT TO WITHHOLD A GST REFUND

Case	Contract Pacific Limited v the Commissioner of Inland Revenue
Decision date	11 November 2008
Act	Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001; Tax Administration Act 1994; Bills of Exchange Act 1908 ("BOEA"); Goods and Services Tax Act 1985 ("GSTA")
Keywords	Section 46 of the GSTA, Commissioner's right to withhold a refund, section 27 of the BOEA

Summary

The High Court concluded that in any investigation of a refund that engages section 46(2)(a) of the GSTA, requests for information made under that investigation will engage section 46(2)(b) as well. Any such requests that do not comply with the time limits in section 46(4) will cause the Commissioner to lose his authority to withhold the refund while he carries out his investigation.

Impact of decision

If the Commissioner, during an investigation that engages section 46(2)(a) of the GSTA, makes a request for information, this will engage section 46(2)(b). Consequently, the Commissioner will need to issue any requests for information as part of that investigation within the time limits set out in section 46(4) or the Commissioner will lose his authority to withhold the refund while he carries out his investigation.

Facts

At relevant times, Contract Pacific carried on the business of an inbound tour operator, selling New Zealand-based holiday packages to overseas wholesalers who then sold to overseas retailers. Those retailers in turn sold to overseas-based holidaymakers who were to visit New Zealand.

Between July 1993 and April 1999, Contract Pacific included GST in the sale prices for the services it sold to overseas wholesalers while other inbound tour operators did not.

In May 1999, the law was changed (with a retrospective effect) to remove any ambiguity over liability to include GST in the sale prices for New Zealand-based services sold to overseas persons for the purpose of on-sale to New Zealand-bound visitors.

On 26 June 2000, on advice, Contract Pacific filed a GST return in which it sought a readjustment and refund of the GST it had paid between 1 July 1993 and 30 April 1999.

The Department's internal computer records for 28 June 2000 record a GST assessment from the taxpayer for a refund of $7,345,396.94. With the effect of additional sums, the entire refund totalled $7,542,295.51.

On 10 July 2000, the Commissioner advised that the GST refund had been withheld pending investigation of the readjustment claim.

Through an administrative error, a notice of assessment and refund cheque for $7,542,295.51 were issued on 5 February 2001. On 9 February 2001, the Commissioner became aware of the error and took steps to stop payment on the refund cheque.

Until 2 April 2001, the Commissioner advised the GST claimants that further investigation of their claims was required. On 2 April 2001, the Government introduced the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill ("the Bill").

On 2 July 2001 a notice of assessment was sent which disallowed the credit adjustment and consequential refund Contract Pacific sought.

On 24 October 2001, the Bill came into force as the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 ("2001 Act"), with retrospective effect. The general effect of the new legislation (section 241) was to make clear there was and always had been liability to pay GST on the service dispute. There was a savings provision

that exempted a small category of persons from its effect. Contract Pacific would come within this savings provision if the circumstances of receiving the refund cheque meant it had been paid a refund.

After the enactment of the 2001 Act, the Commissioner entered into written agreements with the various GST claimants pursuant to section 89I of the Tax Administration Act 1994 ("TAA") to resolve the claims for readjustment of GST paid on facilitation fees and quantification of the Commissioner's liability to pay use of money interest.

On 11 December 2001, the Commissioner sent a letter to Contract Pacific which stated that the Commissioner's investigation into the inbound tour component of the taxpayer's GST affairs had been completed, resulting in the reassessment of periods ended 28 February 2001 and 30 April 2001 to allow a refund that reflected the overpaid GST for the period 30 June 1993 to 30 April 2001.

On 18 April 2005, a request was made to the Commissioner for payment of $6,281,767 plus interest, being the balance of the dishonoured refund cheque of $7,542.295 after the payment of the facilitation fee credit adjustment was deducted. The Commissioner rejected the claim.

Decision

As it was contended that the credit adjustment agreements were a complete bar to Contract Pacific's legal claims, the Court decided to consider the third issue first. Duffy J concluded that contrary to the Commissioner's assertion, the credit adjustment agreements did not bar Contract Pacific from suing for the balance of the credit adjustments it claimed it was due.

Duffy J then went on to consider the remaining three issues.

Issue one

Duffy J held that whether or not in this case there was antecedent debt or liability that was capable of constituting valuable consideration under the BOEA turned on the interpretation of section 20(5) and section 46 of the GSTA.

Section 20(5) requires the Commissioner to refund any excess where the total amount that may be deducted for a taxpayer's output tax exceeds the aggregate amount of the output tax for that taxable period. Section 46 deals with the Commissioner's right to withhold payments. It mandates that if the Commissioner is required to refund an amount under section 20(5), he shall do so within 15 days of receipt of the return subject only to his powers under section 46(2) to withhold payment.

After referring to the decision in CIR v Sea Hunter Fishing Limited (2002) 20 NZTC 17,478, Duffy J concluded that section 46 is a code for the authority to withhold payment of disputed GST refunds. In her Honour's opinion, there is only one interpretation of section 46(2) that does not undermine Parliament's intent to impose strict limits on the Commissioner's authority to withhold a refund. This is that whenever the Commissioner is faced with a refund issue under section 46 that requires both an investigation and the collection of further information, the two limbs of the section must be used in conjunction. Therefore, in any investigation of a refund claim that engages section 46(2)(a), requests for information will engage section 46(2)(b) as well. Any such requests that do not comply with the time limits in section 46(4) will cause the Commissioner to lose his authority to withhold the refund while he carries out his investigation. While the Commissioner need not engage both limbs of section 46(2), where his actions do entail both an investigation and a request for information he must comply with the prescribed time limit.

In this dispute, the Commissioner had issued a notice under section 46(2)(a), notifying his intention to investigate the matter, and had done so within the 15-day time limit prescribed in section 46(5). However, the Commissioner also made requests for information pursuant to that investigation, but these were made outside the prescribed time limits in section 46(4). Accordingly, Duffy J concluded that he "lost his authority to withhold the disputed refund".

Further, Duffy J found that the effect of finding that the Commissioner lost his authority to withhold the payment when the refund was issued meant that he was under an antecedent liability to pay the refund to Contract Pacific. That liability was sufficient to provide valuable consideration for the purposes of section 27(1) (b) of the BOEA. Consequently, this entitled Contract Pacific to judgment for that amount. Her Honour also held that the passing of section 241 of the 2001 Act could not on itself cause a failure of that consideration.

Issue two

Contract Pacific had argued (in the alternative) that it was subject to the savings provisions in section 241(6) (a) or alternatively (c) of the BOEA.

In relation to the arguments under section 241(6) (a), Contract Pacific asserted that it had been "paid" a refund on or before 14 May 2001 and was therefore immune from the retrospective effect of the legislation. Duffy J concluded that under the common law, the issue of a cheque is a payment. Further, her Honour held that given it had already been concluded that the cheque issued on 5 February 2001 was valuable consideration, the position was "unaffected by section 241(6) and remains the same today as it was then".

In relation to the arguments put forward regarding section 241(6) (c) (ie that Contract Pacific was exempt given the Commissioner, on or before 14 May 2001, reduced the amount that would otherwise be tax payable in respect of the supply), Duffy J considered it unnecessary to determine whether Contract Pacific was entitled to a refund by virtue of that provision. This was because Contract Pacific had accepted that the success of both causes of action under section 241 depended on whether or not the Court found the refund cheque was a payment of the credit adjustment refund the company claimed (ie the first issue). In addition, Duffy J had some concerns regarding the Court's jurisdiction to grant the relief sought.

Issue three

The Commissioner sought to argue that even if Contract Pacific could succeed in the action on the cheque, the consequential liability to pay the proceeds could be negated by set-off and that given a notice of assessment was issued which the taxpayer failed to respond to, it was too late for Contract Pacific to dispute the assessment.

Duffy J rejected this action. Her Honour found that the letter of 11 December 2001 was not sent as a notice of assessment but did note that there is a difference between an assessment and a notice of assessment. However, Duffy J found it unnecessary to conclude whether or not the letter of 11 December 2001 was in law a notice of assessment.

This was partly because her Honour did not want to risk offending against the limits in the TAA on the power of the Court to make determinations outside Part 8A in relation to disputed assessments. In addition, Duffy J noted that the set-off had not been pleaded by the Commissioner and was brought late in the proceedings, denying Contract Pacific the opportunity to "shape its case".

TAXPAYERS' SECOND JUDICIAL REVIEW SUCCESSFUL

Case	Chesterfields Preschools Limited and Ors v the Commissioner of Inland Revenue
Decision date	25 November 2008
Act	Judicature Amendment Act 1972
Keywords	Judicial review

Summary

The Commissioner was found to have failed to apply the orders made in earlier judicial review proceedings and was ordered to comply with the earlier orders.

Impact of decision

The decision confirms that the Commissioner whenever possible must follow the directions given by the Court in judicial review proceedings

Facts

This judicial review was of the Commissioner's application of the taxpayers' earlier judicial review (reported at (2007) 23 NZTC 21,125).

In that decision the Judge ordered:

1. Reconsider the application for re-registration of Anolbe, treating the application as having been made on 27 March 2000 (on the basis it would have been completed formally had there been an appropriate reaction from the Commissioner's staff on receipt of the letter).
2. Consider the legitimacy of all the Anolbe GST returns, including those filed on 27 March 2000 and any other unresolved refund claims by other plaintiffs. The time ban provisions shall not apply.
3. Apply such refunds as are upheld to best fiscal advantage to the plaintiffs.
4. Make a decision under section 182 of the TAA, as preserved by Taxation (Remedial Provisions) Act, section 103, treating the historic correspondence and meetings from and with Mr Hampton as substantive requests for remission, in respect of all the plaintiffs, received before 23 September 1997, and in so doing recognise that Mr Hampton was led to believe that the GST input claims he was lodging would be considered and decisions made upon them and refunds lodged to the best advantage of the plaintiffs.
5. Make a decision under section 183A, as to remission in respect of the period that has elapsed while this litigation has been proceeding.
6. The Commissioner may, in the usual way, continue to exercise his general powers under section 6 and 6A of the TAA, without derogating from the benefits that would accrue to the taxpayers by reason of the reconsideration of the foregoing matters.

The Commissioner, in a decision to address the orders outlined above (the Budhia decision), addressed each of these orders in turn and made decisions under each heading. The taxpayers argued the Commissioner had failed to apply the orders and commenced a second judicial review. The Commissioner argued that he had fully complied with the orders made.

Decision

The Judge considered the Commissioner had failed in every particular to apply his earlier order saying:

> [90] The Commissioner's officers were in breach of section 4(6) of the J[udicature] A[mendment] A[ct] by not having regard to the Court's reasons for giving the directions, and erroneously construing those directions. Non-compliance pervaded the analysis and decision making that went to the Commissioner's purported compliance with the directions.
>
> ….
>
> [92] In respect of the December judgment paragraph [155] is intended to encapsulate the consequence of a large number of earlier findings but is not itself to be read as capturing all the reasons. To the extent that the IRD officers did use the reasoning in the December judgment, it was selective.
>
> [93] Accordingly, the appropriate relief in this case is to redirect the Commissioner back to the December judgment. That judgment has not been qualified in any way by this judgment. This judgment is to be understood as identifying errors of the Commissioner purporting to carry out the directions of that judgment, and, as part of that exercise, it does contain further elaboration/interpretation of the December judgment. Accordingly, the reasons of this judgment also bind the Commissioner and must be taken into account in giving effect to the directions. The Commissioner is directed to begin again the task of discharging the duties imposed on him by the December judgment.

The Judge awarded costs against the Commissioner. Further submissions are to be made on this point.

BACKDATED ACC COMPENSATION NOT DOUBLE TAXED

Case	TRA Decision Number 03/2009
Decision date	14 January 2009
Act	Income Tax Act 1994 and Tax Administration Act 1994
Keywords	Income-tested benefit, PAYE, ACC, backdated compensation

Summary

The disputant received a taxable income-tested benefit and non-taxable supplementary benefits comprising disability and accommodation allowances from Work and Income New Zealand (now Ministry of Social Development and referred to below for convenience as "MSD") for a period for which she was later determined to be entitled to weekly compensation from the Accident Compensation Corporation ("ACC").

The dispute between the parties arose out of what took place when the change-over from MSD to ACC as the paying agency occurred and the effect of that for tax purposes in the 2004 income year.

Impact of decision

Although confined to its specific facts, this case sets out the mechanics of the relationship between the various benefits, ACC and tax.

Facts

During 2004 the disputant received two lump sum payments from ACC, representing weekly entitlements which had not been paid from 1998 to 2003. However, during the period of entitlement the disputant had also been receiving an income-tested benefit and supplementary benefits from MSD. The lump sum ACC payments attributable to the 1998 to 2003 period affected the disputant's eligibility for income-tested benefits and MSD required reimbursement of those amounts which had been paid.

When calculating the lump sum amounts to be paid, ACC deducted an amount equivalent to the gross income-tested benefit which had previously been received by the disputant, being the amount required to repay MSD including PAYE due on that amount. Tax was then deducted from the remaining lump sum amount, being the backdated weekly compensation arrears before the amount of non-taxable supplementary benefit was deducted and reimbursed to MSD. The total amount of tax deducted was then paid to the Inland Revenue Department.

The disputant considered that this resulted in double taxation and also argued that PAYE on the backdated compensation should not have been taxed in one year but spread across the years in which the ACC entitlement arose. This would have resulted in the lump sum payments being taxed at a lower marginal rate.

Decision

Barber DCJ held that no double taxation had occurred. The amount equal to the PAYE on the income-tested benefits, which ACC deducted, was the amount of tax due on that portion of the back-dated weekly compensation. That tax was paid on the disputant's behalf by MSD through the multi-department reimbursement process and accordingly, the disputant had not been taxed twice.

Barber DCJ also noted that the disputant's entitlement to the income-tested benefit was a net entitlement and that while PAYE was paid on behalf of the recipients of benefits, they had no entitlement to a refund of that amount.

Barber DCJ considered that because ACC treated the amounts the disputant originally received as having been paid in respect of the disputant's claim, the plain wording of section 78(2) of the Accident Rehabilitation Compensation Insurance Act 1992 deemed those amounts to have been paid as weekly compensation, and therefore part of the disputant's gross income.

Numerous cases were cited to show that it was settled law that a taxpayer derived income when it was received and it could not be spread back into earlier years to which the computation of income related. Accordingly, Barber DCJ held that the amount of the backdated weekly compensation received by the disputant from ACC in the 2004 income tax year was properly assessed as gross income under CC1(1)(b) of the Income Tax Act 1994, in that year.

SUPREME COURT UPHOLDS COMMON LAW POSITION ON PROOF OF AMOUNT IN PAYE AND GST OFFENDING

Case	Smith v R
Decision date	12 December 2008
Act	Tax Administration Act 1994, section 109, 143B (1)(b) and (f), and 143A(1)(d).
Keywords	Specific amount, evasion, prosecution, element of offence

Summary

The Supreme Court declined Mr Smith's application for leave to appeal on three questions of law. The overall effect of this case, together with the Court of Appeal decision, is that the general position at common law that value is not an element of an offence, unless the essence of the offence is to continue to apply to a section 143A(1)(d) offence.

It is only necessary for the Crown to prove that an amount of the PAYE deduction has been misapplied; it does not have to prove the precise amount of the deduction that has been misapplied.

The Courts also found that the Crown did not have to prove that a particular amount of GST, or even some, was payable to prove the evasion part of a charge. The intention of evading assessment was sufficient: *R v Fepuleai* [2008] NZCA 339 applied and endorsed by the Court of Appeal.

Impact of decision

These decisions preserve the status quo.

Facts

Following trial before Judge Maze and a jury in the Hamilton District Court, the appellant and his wife were found guilty on 94 counts alleging offending between 2001 and 2006 against the Tax Administration Act 1994. The appellant was sentenced to two and a half years imprisonment and his wife was sentenced to nine months home detention.

Mr Smith unsuccessfully appealed to the Court of Appeal against both his conviction and sentence (*R v Geoffrey Martin Smith* CA CA275/2008 [2008] NZCA 371). The appellant then sought leave to appeal to the Supreme Court.

Decision

The Court considered the three propositions, and answered the first two on the basis that there was no requirement or basis to read into the relevant provisions proof of a specific amount; and describing the third argument as "equally hopeless", saw no justification for giving the words in section 109 anything other than their plain meaning.

As the three propositions of law advanced were untenable, and there was no appearance of a miscarriage of justice, the Court dismissed the application for leave.

TEMPLATE AVOIDANCE SCHEME ASSESSMENTS CONFIRMED

Case	TRA Decision Number 1/2009
Decision date	16 January 2009
Act	Income Tax Act 1976, section 99
Keywords	Tax avoidance

Summary

Tax avoidance template scheme; repetition of arguments already dealt with by the Courts; Commissioner's assessments confirmed.

Impact of decision

This matter is largely confined to its own facts although it confirms the Commissioner's view of this particular tax avoidance scheme.

Facts

This is the final judgment arising from an interim decision delivered on 26 November 2007 (Case Y20 (2008) 23 NZTC 13, 207). As part of the interim decision Barber J reserved leave for the parties to make further submissions and raise any new issues. Further submissions were received and conferences were held prior to the judgment being issued.

The judgment deals with income tax assessments against three groups of taxpayers ("the objectors") covering the 1986 to 1991 income years. This matter arose as the result of reassessments issued to the objectors to counteract a tax advantage obtained by them under a tax avoidance arrangement pursuant to section 99 of the Income Tax Act 1976 ("the Act"). Objections were filed in relation to the Commissioners' reassessments.

All issues in this case relate to participation by the objectors in what is well-known as the *Russell Tax Avoidance Templates*. Broadly, during the early 1980s Mr Russell commenced acquiring profitable companies and businesses through agents or nominee companies. The vendors were required to provide 100 percent vendor finance but were given a premium on their share price and an option to repurchase the assets of the business conducted by their company at a later date should they wish to. It was pleaded that the purpose of the option was to give those vendors an assurance that they would not lose their livelihood if the new venture was not as profitable as anticipated.

The operating company became a member of the Russell Group of companies which had associated companies with tax losses available to be carried forward. The template technique involved a management contract whereby a Russell entity provided services to the operating company which then became liable to pay administrative charges and consultancy fees to the Russell entities.

It was accepted by the Commissioner that the objectors were not aware of the Russell business empire and were not aware of the arrangements to utilise tax losses in this group. The vendor objectors never received the income of the subsidiary trading company, which had previously been their company. It was also accepted the objectors entered into these transactions to acquire capital gain on the sale of the business or business entity to the Russell group and to obtain continuing administrative and financial assistance after that.

Decision

Most of the issues and arguments raised by the objectors subsequent to the interim decision were identical or very similar to issues and arguments which have been conclusively dealt with in either the interim decision itself or in other litigation involving the Russell tax avoidance scheme. Barber J disposed of most of the issues raised by reference to his earlier findings or those of the appellate courts.

Issue estoppel

Barber J noted that this was a repetition/recycling of the arguments by the objectors which had been dealt with over and over again in successive Russell cases. The Privy Counsel and the Court of Appeal had both dealt with this issue in *O'Neil v CIR* (2001) 20 NZTC 17,051 (PC) and *Wire Supplies v CIR* (2007) 23 NZTC 21,404 respectively as did Barber J himself in the interim decision. His Honour agreed with counsel for the Commissioner that repetition of arguments by the objectors is an abuse of process and saw no circumstances for not applying estoppel in the present case.

Evidential requirements – Peterson v CIR (2005) 22 NZTC 19, 098 (PC)

This issue had already been dealt with in the interim decision and Barber J refused to re-open that issue.

The effect of section 99(4) of the Act

This issue had already been dealt with in the interim decision and Barber J refused to re-open that issue.

Statute bar

This issue had already been dealt with in the interim decision and Barber J refused to re-open that issue. Barber J noted that this issue was dealt with by the Privy Council in O'Neil and the Court of Appeal in Wire Supplies and agreed with counsel for the Commissioner that to allow repetition of these arguments by the objectors would be an abuse of process.

The standard allowance to each objector company in respect of the consulting fee

This issue was substantively dealt with in the interim decision, though certain allowances were made for companies which were previously struck off where there was leave to restore those entities to the companies register.

Whether the Commissioner had identified the scheme and had shown that it had the purpose or effect of tax avoidance

This issue was fully dealt with in the interim decision and in appellate courts and was not re-opened.

The exhaustion of the Commissioner's discretion issue

This issue was dealt with in the interim decision and in Wire Supplies,. Barber J found that the objectors were simply trying to re-litigate old issues and declined to deal with it.

Additional taxes

Barber J noted this issue was comprehensively dealt with in Wire Supplies and also in Withey v CIR (No 2) (1998) 18 NZTC 13,732. These cases confirmed there was no right of objection in relation to additional taxes and those decisions applied to all of the Russell template objectors.

Sundry

With regard to Consultant Applications, Mr Russell submitted the arrangement differed from the other template cases because it involved the purchase of a business from an Australian owner. Barber J declined to re-open this issue because the purchase of the business from an Australian vendor did not have any material effect on the outcome of the template application.

The objectors in the three groups were unable to show that their respective assessments were incorrect or flawed in any way. All assessments were confirmed.

SUPREME COURT RULING ON "TRINITY"

Case	Ben Nevis Forestry Ventures Limited and Ors v the Commissioner of Inland Revenue
Decision date	19 December 2008
Act	Income Tax Act 1994, sections BG 1, DL 1, EF 1, EG 1, EH 2, FE 4, GB 1, OB 1, schedule 17; Tax Administration Act 1994, sections 141B and 141D; Income Tax Act 1976, section 99; Land and Income Tax Act 1954, section 108; Income Tax Act 2004, section EZ 45.
Keywords	Tax avoidance, arrangement, depreciation, unacceptable interpretation, abusive tax position, licence premium, insurance, reconstruction and penalties

Summary

Having regard to the various features of the Trinity investment arrangement, the Court concluded that the taxpayers' use of the specific provisions was not within Parliament's purpose and contemplation when it authorised deductions for the licence premiums and insurance premiums under the depreciation provisions. The taxpayers altered the incidence of income tax by means of a tax avoidance arrangement which the Commissioner correctly treated as void against him. Further, the taxpayers had taken an abusive tax position because their position was an unacceptable interpretation of tax law; and therefore they were liable for the 100 percent penalty imposed by the legislation.

Impact of decision

This decision will have significant and lasting implications for matters engaging section BG 1, and clearly directs that the Commissioner ought to advance a matter on the basis that there is a sham, or avoidance, but not both.

Background

This was an appeal to the Supreme Court by nine investors, or loss attributing qualifying companies (LAQCs) of the investors, in a syndicate that had been involved in the development of a Douglas Fir forest project as part of what is known as the Trinity scheme.

The essence of the case is the long-standing search for clarity over where formal compliance with specific provisions ends and tax avoidance begins. The taxpayers had invested in a genuine forestry investment (a forest was planted) which had been structured to take advantage of specific taxation provisions authorising deductions and depreciation allowances; the Commissioner took the view that strict compliance with those provisions did not immunise the arrangement from being categorised as tax avoidance.

Facts

The appellants were investors in a syndicate that had been involved in the development of a Douglas Fir forest project as part of what is known as the Trinity scheme. The forest was planted in Southland and is due to be harvested by 2048.

The land on which the forest was planted was purchased and held by Trinity Foundation (Services No 3) Limited ("Trinity 3"), which was a subsidiary of Trinity Foundation Ltd, which in turn was owned by the Trinity Foundation Charitable Trust. The investors did not at any stage acquire ownership of the land.

Investors in Trinity 3 became members of a syndicate called Southern Lakes Joint Venture, which then formed a company, Southern Lakes Forestry Limited, to act as the joint venture's agent. That company entered into various contracts on behalf of the joint venture, which constituted the scheme.

Trinity 3 and Southern Lakes Forestry entered into an agreement for an occupation licence, and later a licence agreement. The occupation licence (for carrying on the forestry business) was stipulated to be at $2,050,518 multiplied by the plantable hectares in the land (ultimately 484 ha). The second agreement provided that the licence

term commenced on 24 March 1997 and expired on 31 December 2048, and also required the syndicate to establish, manage and protect a Douglas Fir forest on the land. The forest was also required to be arranged for sale on the basis that cutting and extraction should be completed during the period 31 December 2044 to 31 December 2048, and specified the order in which the proceeds from that sale would be applied.

The investors were also required to pay Trinity 3, on 21 March 1997, $1,250 per plantable hectare ("/p ha") for the establishment of the forest, $1,946/p ha for an option to purchase the licensed land in 2048, and $1,000 per investor for a lease option. There was an additional $50 annual licence fee during the licence term.

The result was that the investors effectively met the initial costs of buying the land, planting the forest, and the continuing costs of its future maintenance and management, but did not at any point become the owner of the land or the trees. The net proceeds from the sale of the trees (in 2044–2048) would pay the licence premium. On its face there was a risk that the sale would be insufficient to meet the premium, for which insurance was to be taken out by individual syndicate members through Southern Lakes Forestry and Trinity 3.

To provide that insurance, Dr Muir had CSI Insurance Group (BVI) Limited ("CSI") incorporated in the British Virgin Islands. The insurance would be triggered if an event occurred which prevented the market value at sale from reaching $2,050,518/p ha between the event and 31 December 2048, with the insured being the members of the syndicate and Trinity 3. The insurance premiums were $1,307/p ha in 1997, and $32,791/p ha payable on or before 31 December 2047 for the syndicate, and $410,104/p ha on or before 31 December 2047 for Trinity 3. The premium for Trinity 3 was to scale dollar for dollar up to a maximum of $1,230,311/p ha to the extent that the market value of stumpage at 13 December 2047 would be less than $2,050,518/p ha.

The result was CSI insured Trinity 3 and the investors up to $2,050,518/p ha, but due to the scaling premium Trinity 3 was subject to, and the premiums to be paid, the maximum CSI would have to pay would be $787,416/p ha (if net stumpage was zero), and if fewer than 300 trees matured, CSI would not have to pay anything.

Syndicate members provided promissory notes to cover their obligations to pay the licence premium of $2,050,518/p ha in 2048 and to meet their liability to pay the insurance premium in 2047. Trinity 3 provided a promissory note for its 2047 insurance premium liability. Debentures secured the money payable under the promissory notes, the overall effect being to give CSI first rights over the forest until its value exceeded the deferred portion of the insurance premium.

Investors took up proportionate shares in the syndicate by reference to a number of plantable hectares, and in the 1997 claimed deductions from assessable income for:

a) $34,098/p ha for the insurance premiums ($1,307 paid in March 1997 and $32,791 to be paid in cash terms in 2047)
b) A small proportion of the licence premium of $2,050,518/p ha to be paid in 2048 as a depreciation allowance.

In their 1998 returns, the investors claimed the amortised licence premium figure of about $41,000/p ha.

No issue arose over the actual costs of planting and tending trees. Those costs aside, in cash terms investors spent a little under $5,000/p ha in 1997 and $50/p ha in 1998 to qualify for the above deductions.

Decision

Sham

It had not been shown that the parties to the relevant documents were intending to deceive the Commissioner as to the nature of their arrangements in respect of insurance or as to their intention to implement the insurance arrangements according to their tenor [38] (the insurer, the contracts, the forest, and payment of initial premium all having been found by the Courts below, as matters of fact, to exist [36]–[38]).

Deductibility – licence

The licence premium is deductible if it is for a "right to use land", which requires an analysis of the nature of the arrangements actually entered into [46]. The majority held that when considering the application of a specific tax provision, before reaching any question of avoidance, the Court was concerned primarily with the legal structures and obligations the parties had created and not with conducting an analysis in terms of their economic substance and consequences, or of alternative means that were available for achieving the substantive result [47].

In the circumstances in which the transaction had been set up, the licence provided the syndicate with the necessary access to Trinity 3's land to perform its forestry obligations, for which it incurred the licence premium as a cost. The licence gave a 'right to use land' within the meaning of the specific provision and deductible as depreciation on depreciable property, subject to the issue of avoidance [54].

Deductibility – insurance

The present insurance contract is outside the reach of the definition of 'accrual expenditure' and the spreading rules do not apply to it as it was entered into as part of a wider financial arrangement, so the premium did not have to be spread [60]–[64].

Avoidance

Specific tax provisions and the general anti-avoidance provision are meant to work in tandem; each provides a context which assists in determining the meaning and the scope of the other [103]. The purpose of specific provisions must be distinguished from that of the general anti-avoidance provision [103].

Ascertaining when the way a specific provision was deployed crossed the line and turned what might otherwise have been a permissible arrangement into a tax avoidance arrangement should be firmly grounded in the statutory language of the provisions themselves, rather than seizing on past Judicial glosses and elaborations on the statutory language [104].

Where the case involves reliance by the taxpayer on specific provisions, the taxpayer must satisfy the Court that the use made of the specific provision is within its intended scope. If that is shown, then the use of the specific provision by the taxpayer is also to be viewed in the light of the arrangement as a whole. Viewing the transaction as a whole, if the use of the specific provision alters the incidence of income tax in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement [107]. Here the licence premium was within the specific provision as "a right to use land", but viewing the arrangement as a whole, had additional features which caused it to represent and be part of a tax avoidance arrangement [107].

In considering whether a tax avoidance arrangement exists, the general anti-avoidance provision does not confine the Court as to the matters which may be taken into account, and the significance of relevant factors will depend on the particular facts [108].

A classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefits of the specific provision in an artificial or contrived way [108].

The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose [109].

Evaluation of avoidance – licence premium

The Court proceeded on the basis that the expenditure on the licence premium was incurred when the promissory notes were executed [119]; however, that was a jurisprudential rather than commercial meaning of "incurred" [118] The Court considered that the giving of the promissory notes before expenditure had been incurred introduced an artificial element into the arrangement [119].

The amounts paid in comparison to the licence premium raised questions over whether the transaction would be profitable in business terms [121].

The clarity of the tax advantage was in marked contrast to the obscurity of the prospect of any ultimate commercial profit. This led to the conclusion that the primary, if not sole purpose of the promissory note, was to generate a tax deduction for the licence premium [122].

The other feature supporting the conclusion of tax avoidance was the timing difference between the incurring and the commercial payment of the licence premium, such that under the arrangement the appellants would receive the benefits of tax deductions but probably never incur the real expenditure [127].

Evaluation of avoidance – insurance

The formation of a special, single purpose company to undertake the insurance risk in a tax haven, gives rise to immediate issues about the true purpose of what is being done [132]. The evidence suggested that CSI was not intended to be anything more than a pro forma vehicle for obtaining the anticipated tax benefits [138].

Dr Muir was also at pains to try to avoid disclosing the true substance of what CSI did [145].

The letter of comfort given to CSI by the Trinity Foundation Charitable Trust (the ultimate beneficial owner of the Trinity Foundation), led to a substantial element of circularity in the whole insurance arrangement, which fact alone led to a strong inference that the insurance was simply a method whereby substantial tax benefits could be obtained by deducting one lump sum in 1997, a premium not payable in commercial terms until 2047 [146].

The plaintiffs' argument that the execution of the promissory note was done to give CSI a readier means of enforcing payment than if it had simply been left to sue in contract was not accepted as being the principal purpose of the promissory note, there being no transfer of real value to the creditor by substituting one form of obligation for another. The promissory note did not pay the second

premium in any real sense. CSI undertook no real risk and was simply a vehicle to achieve the deductibility of a premium which was not truly paid [147].

The Court viewed the insurance dimension of the Trinity scheme as both artificial and contrived, and the insurance arrangements, as constructed, could not have been within the contemplation of Parliament when it enacted section DL 1(3). The insurance dimension was a material contributor to making the whole Trinity scheme a tax avoidance arrangement.

Avoidance – conclusion

The appellants' use of the specific provisions was not within Parliament's purpose and contemplation when it authorised deductions of the kinds in question. The appellants altered the incidence of income tax by means of a tax avoidance arrangement which the Commissioner correctly treated as void against him [156].

Novel point

The Court declined to allow the new point raised by Accent Management Limited to be taken, giving as reasons that leave had not been granted to raise that point, nor would it have been appropriate to grant leave at the hearing in the face of opposition by the Commissioner [151].

Participation

All appellants entered into a tax avoidance arrangement simply by becoming members of the syndicate and parties to the agreements with Trinity 3 [159]. On the ordinary meaning of the "any person affected by that arrangement" and "that person" in section GB 1, once the existence of a tax avoidance arrangement has been established, all those taxpayers who have benefited from it may be subject to corrective adjustments by the Commissioner; the taxpayer need not even be aware of the tax avoidance aspect [164] or directly involved [168]. A taxpayer who claims a deduction in terms of a tax avoidance arrangement can hardly claim not to be affected by the arrangement [168].

Reconstruction

The appellants had not established that the Commissioner adopted a reconstruction which was outside the scope of his powers [170]. It is settled law that the onus is on the taxpayers to demonstrate not only that the reconstruction is wrong, but also by how much it is wrong, and in this case the appellants had done neither. In particular, the appellants had not submitted any particular reconstruction of their own which the Court could then have evaluated [171].

Penalties

While the expenditure for the licence premium and insurance premium satisfied the ordinary meaning of the specific provisions relied on for claiming the deductions this was not enough on its own. Features of the arrangement led the Court to conclude that the arrangement was clearly a tax avoidance arrangement, with the effect under section 141D(6) that the appellants in their returns took an incorrect tax position under a general anti-avoidance tax law [182]. The appellants' tax position failed to meet the required standard of "about as likely as not to be correct" [203].

Due to the wording of the statute (the qualification in section 141D(7)(b) reinforced by section 141D(7)(b)(ii)), the dominant purpose to be considered was the dominant purpose of the arrangement itself, not the dominant purpose in the mind of each taxpayer.

It followed that the appellants each took an abusive tax position, and subject to particular further arguments from three appellants, were liable for the 100 percent penalty imposed by the legislation.

Double penalties

The argument advanced by Ben Nevis and Greenmass was not accepted, with the Court sharing the view of the Court of Appeal that the language of the definition of "tax shortfall" covered the position of each LAQC, and nothing in the Act enabled the Court to read down the words of the definition [214]. The Court observed that the double penalty issue had been subsequently addressed by the enactment of section 141FC of the TAA [215].

The argument advanced by Redcliffe Forestry Venture Limited that its own ultimate position was not to claim a loss was not in point, and viewed as a whole Redcliffe's return involved taking a tax position in relation to the Trinity scheme which resulted in too little tax being paid by Redcliffe's shareholders. This was a tax shortfall and Redcliffe was correctly held liable to a shortfall penalty [218].

Appeals dismissed and costs to the respondent.

THE COURT CONFIRMED SECTION 76 IS A GENERAL ANTI-AVOIDANCE PROVISION AND EVERY AVOIDANCE ISSUE NEEDS TO BE ADDRESSED OBJECTIVELY ON ITS MERITS

Case	Glenharrow Holdings Limited v the Commissioner of Inland Revenue
Decision date	19 December 2008
Act	Goods and Services Tax Act 1985, section 76
Keywords	Input deduction, tax advantage, tax avoidance and economic burden

Summary

An arrangement was entered into by the taxpayer for the purchase of a mining licence for $45 million for which the taxpayer sought an input tax deduction. The transaction was void under section 76 of the Goods and Services Tax Act 1985 (GSTA). The Court found that the effect of the structure supporting the transaction was to produce a GST refund totally disproportionate to the economic burden undertaken by the taxpayer. They found that the end in view was a distortion which very plainly defeated the intent and application of the Act.

Impact of decision

A well reasoned decision which confirms that where transactions are not a "sham", the Commissioner is still entitled to consider the tax consequences of the transactions under section 76 of the GSTA. The court has confirmed that section 76 is a general anti-avoidance provision and therefore every avoidance issue will need to be assessed objectively on its merits on a case-by-case basis.

Facts

This case dealt with the treatment by the Commissioner of a GST second-hand goods input claim made by Glenharrow Holdings Limited ("Glenharrow") after Glenharrow purchased a mining licence from Michael Meates for the sum of $45 million.

The mining licence was issued in November 1990 for a period of 10 years. It was purchased in 1996 by Michael Meates for $10,000. Michael Meates did not claim GST on the mining licence and did not use it as part of a GST-registered activity. Michael Meates was approached by Gerard Fahey who wanted to purchase the licence. A valuation of the licence was undertaken by Mark Meates, a cousin of Michael Meates. Mark Meates was not a registered valuer but had studied valuation as part of his MBA. He placed a value on the licence of somewhere between $45 million and $180 million.

Gerald Fahey agreed on behalf of Glenharrow to pay $45million on the basis there would be vendor finance. A skeleton agreement was recorded between the parties which provided for an $80,000 deposit, with the remaining $44.920 million to be vendor financed. At the time Glenharrow had a share capital of $100. The deposit was obtained from its shareholder Gerald Fahey. When the licence was transferred Glenharrow gave Michael Meates a cheque for the remaining $44.920 million. Michael Meates then gave Glenharrow a cheque for the same amount as an advance by way of loan to Glenharrow. Glenharrow delivered to Michael Meates a general mortgage debenture over all its assets and over its shares. The mortgage was executed by Gerald Fahey but was without personal liability to Gerald Fahey.

The Commissioner refunded GST in relation to the deposit of $80,000 when it was claimed by Glenharrow. However, the application for a refund of $4,991,111 for the balance of $44.920 million was declined.

The statutory consent process for the transfer of the licence from Meates to Glenharrow was not completed until November 1998. By the time the licence expired in November 2000 Glenharrow had mined only 36 tonnes of rock.

High Court decision

Chisholm J found that the transaction was not a sham and that the principal purpose for the purchase of the licence was for the making of taxable supplies. Notwithstanding that, Chisholm J held that section 76 did not require proof of a subjective intention and was directed at the effect or purpose of the arrangement. He noted that the definition of "tax advantage" in section 76 (4) of the GSTA included an increase in the entitlement of any registered person to a refund of tax. Chisholm J then concluded that if the consideration for the licence was grossly inflated the input tax would also be grossly inflated. He found that the appropriate value for the mining licence was $9.757 million. The Commissioner was ordered to credit Glenharrow with a GST input deduction for the GST on the $9.757 million.

Court of Appeal

Glenharrow appealed against the High Court finding of avoidance. The appellant claimed there could not be any tax advantage in terms of section 76 as the High Court found they had acquired the licence having paid $45 million for the principal purpose of making taxable supplies.

Glenharrow considered their case analogous to Peterson v CIR [2006] 3NZLR 433. The Commissioner cross-appealed against the valuation of the tax advantage allowed. He argued that the concept of payment had been met in purely juristic terms, there was no definitive commitment to pay and that the economic burden intended by Parliament had not been suffered by Glenharrow.

The majority of the Court of Appeal found Chisholm J was not wrong to find tax avoidance on the basis of a grossly inflated value. The majority were satisfied that there had been a significant temporal mismatch and that the line had been crossed into tax avoidance. The tax advantage for Glenharrow was seen as an increased entitlement to a refund received without suffering the economic burden intended by the Act. The Court considered the case of Peterson was distinguishable due to the factual findings regarding the economic burden suffered and the scope of the inquiry.

Decision

The appeal from Glenharrow was dismissed. Reasons were delivered by Blanchard J. The Court accepted that before looking at the provisions of section 76, the position in relation to the sale of the licence was that the licence was a second-hand good. The deed of sale provided for a consideration of $45 million in money and the open market value provisions of the Act did not apply to the agreement which was considered to be at "arms length". They then considered the operation of section 76.

The Court confirmed that section 76 assumed that the arrangement under scrutiny was not a sham. The section 76 determination requires an assessment that goes beyond the technical legality of the constituent parts of the arrangement. The onus is on the taxpayer under section 149A(2)(b) of the Tax Administration Act ("TAA") to show that the Commissioner could not have been properly satisfied that section 76 applied in the circumstances.

There is a two-stage process before the Commissioner can carry out a section 76 reconstruction. Firstly there must be an arrangement entered into between at least two persons. Secondly the Commissioner must be properly satisfied that the arrangement was entered into between the two parties *to defeat the intention or application of the Act or any provision of the Act.* This does not mean that the Commissioner must be satisfied that the parties subjectively had that defeating purpose. A natural reading of section 76, as it stood prior to 2000, was to require the Commissioner to be satisfied that an arrangement had been entered into so as to defeat the intent and application of the Act.

The Commissioner was required to ask what the purpose of the arrangement was. This question in turn required examination of the effect of the arrangement. The Court followed the findings in *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] AC 450 in relation to the term "purpose or effect" where Lord Denning found that the word purpose did not mean "motive" but rather "the effect which was sought to achieve". *The crucial distinction is that general anti avoidance rules are not aimed at the purpose of the parties but at the purpose of the arrangement.* The Court also followed the findings of the Privy Council in *Ashton v Commissioner of Inland Revenue*, [1975] 2NZLR 717, where Viscount Dilhorne confirmed that, "if an arrangement has a particular purpose, then that will be its intended effect".

The Court found that any assessment would principally be a matter of inference from the arrangement and its effect. The intention of the Act would be defeated if an arrangement had been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence was outside the purpose and contemplation of the relevant statutory provisions.

The Court examined the history behind the GSTA and the need for avoidance legislation. It determined that GST was a type of "value added tax" intended to be broad based, efficient and neutral. The Court concluded that registered persons producing taxable supplies effectively operated as tax collectors on behalf of the Government and as such were not themselves subject of the GST's economic incidence. By the same token it was recognised that registered persons should not obtain unacceptable windfall gains from the regime. They found that reading the Act as a whole it was clear that the legislature anticipated that for a trader in goods and services there would over time usually be some balancing out or netting off of the GST components of sales and purchases.

The Court recognised that there was potential for registered taxpayers to create distortions at the boundary between themselves and unregistered persons. It said that the same could occur where transactions were between those registered on a payments basis and those registered on an invoice basis. The Court confirmed that the general anti-avoidance provision was available to stop or counteract both these distortions.

The Court concluded that it did not need to form a view on whether or not the price paid for the licence was the market value. However, it did rule that even though there was stone to be extracted while the licence was running the arrangement still had a very artificial element. The Court noted that an objective observer could have said that Glenharrow would never have been able to mine enough stone during the term of the licence to generate sufficient sales to pay for the licence. There was no issue that Glenharrow undertook liability for the $44.920 million funded by vendor finance. However Glenharrow was a shell company with a share capital of just $100. Michael Meates was unregistered and there was no GST impost on the other side of the transaction. The Court found that the effect of the structure was to produce a GST refund totally disproportionate to the economic burden undertaken by Glenharrow. They found that the end in view was a distortion which very plainly defeated the intent and application of the Act.

SECTION 157 CATCHES AGENT

Case	Enterprises Lakeview Limited v the Commissioner of Inland Revenue
Decision date	13 November 2008
Act	Tax Administration Act, section 157; Goods and Services Tax Act 1985, section 43
Keywords	Deduction notice, agent, fraudulent use of corporate entity

Summary

The plaintiff company sought judicial review of the Commissioner's advice and receipt of funds under a statutory deduction notice which did not name the plaintiff company. The Court considered that the plaintiff company on the evidence before the Court was simply a front obviously carried on by Mr Smith, who was the subject of the section 157 notice, for the purpose of evading the tax implications. The Court considered the Commissioner's actions were justified and dismissed the application for judicial review.

Note that this was a case where, on the facts, the debtor owed money to the defaulting taxpayers; however, the latter chose (unsuccessfully) to hide the true position by using a front.

Impact of decision

This decision illustrates in the revenue context an application of the traditional position that the Courts will not allow the corporate form to be used for purposes of fraud or as a device to evade legal obligations where advantages of incorporation are used and intended to deprive others of their rights.

Background

This was an application for judicial review which also included civil causes of action (alleging conversion, breach of fiduciary duty, and an action for money had and received).

The outcome of all causes turned on the lawfulness of a statutory deduction notice issued under section 157 of the Tax Administration Act 1994 ("the TAA") to a debtor to a kindling business. Subsequent to the notice being issued, the plaintiff allegedly took over the business and sought to recover monies which the debtor had remitted to the Commissioner under the notice.

Facts

Mr and Mrs Smith owned and operated a business of providing kindling and trellis fencing. The business initially operated as a partnership trading as "Trellis and Fencing Warehouse", then subsequently transferred to a company, Trellis and Fencing Warehouse Limited (TFW Ltd). In 2004, the Commissioner assessed the partnership for income tax and GST in excess of $450,000, and for PAYE (in respect of deductions not made for employees) of over $110,000. TFW Ltd had also failed to file tax returns and was issued with default assessments.

On 2 October 2007, the Commissioner issued a deduction notice under section 157 of the TAA to one of their debtors. The defaulters listed in the notice were both the taxpayers in the partnership and TFW Ltd. Deduction notices were also issued to other debtors of the defaulting taxpayers.

On the same day as the deduction notice was issued by the Commissioner, TFW Ltd (acting through Mr Smith) purported to sell the business to Ms P, for $25,000.

On 8 October, the Commissioner received payment from the debtor for the amounts in invoices rendered on 2 and 3 October 2007.

On 17 October, the plaintiff company, Enterprises Lakeview Limited was incorporated.

On 18 October, the debtor received a further invoice said to be from "Lakeview Enterprises", and raised the matter with the Commissioner. Following an investigation and interview with Ms P, the IRD advised the debtor on 19 October 2007 that the Department was of the opinion that Lakeview Enterprises was merely an agent for either Mr and Mrs Smith or TFW Ltd, and that funds should be paid to the Department in accordance with the section 157 notices. A total of $22,682.70 was received and applied to outstanding PAYE arrears.

The plaintiffs filed these proceedings on 17 November, the same day the liquidation of TFW Ltd was advertised. The affidavit in support of the application also revealed that Ms P had cancelled her purchase of the business on 22 October 2007.

Throughout this time Mr and Mrs Smith were being investigated for large amounts of suppressed income and PAYE unaccounted for over a lengthy period. Charges were laid on 27 July 2006 and they were found guilty after trail by jury on 20 February 2008.

Decision

Gendall J dismissed the application for judicial review based on the issue of the section 157 TAA notices, holding that the application was misguided.

Gendall J held that the section 157 deduction notice was lawfully issued to the debtor. Turning to the advice the Commissioner had subsequently given to the debtor, his Honour considered that the lawfulness of the Commissioner's actions would depend on factual matters and whether the Commissioner acted ultra vires, or unreasonably, or took into account irrelevant considerations.

After noting that even in judicial review proceedings factual issues may need to be decided by the Court, his Honour determined that the purported transfer of the business never came into operation: at [40] "However Mr Smith describes it, the sale did not happen". Further the registration of the company on line was simply to cloak what Mr Smith was doing, and that Mr Smith was continuing to trade under various guises.

His Honour at [48] observed that where a corporate entity was a sham or façade designed to conceal a shareholder or another's involvement in a particular matter, then it had long been recognised that this was a fraudulent use of corporate entity, and would not be countenanced. The evidence had established that the plaintiff company was acting as agent for Mr Smith and in fact doing his business not its own at all and that it was a front obviously carried on by Mr Smith for the purpose of evading the tax implications.

At [51] his Honour agreed that it was entirely open for the Commissioner to assert that the funds were in fact aimed to go to the defaulting taxpayers.

His Honour concluded that on the facts of this matter the Commissioner's advice to the debtor on 19 October 2007 was fully justified, reasonable, and not in excess of the Commissioner's jurisdiction.

His Honour also found that the decision in *CIR v ANZ Banking Group (NZ) Ltd* (1998) 18 NZTC 13,643 (where a bank was held not to be required to pay the Commissioner monies held in a joint husband and wife account without the wife's consent) was distinguishable, because in the present case, the debtor did not resist the payment of monies owed to the defaulting taxpayers. The plaintiff's argument that it was entitled to receive payment from the debtor, because the taxpayer was not named in the section 157 notice and was not the defaulting taxpayer, was also unsustainable as a matter of fact.

His Honour also held that the further causes of action raised by the taxpayer could only proceed in a normal civil action, following usual civil procedure, and could not simply be merged into the judicial review application. The causes of action as pleaded under "Civil Claims" were adjourned; however, his Honour observed that the findings as to the lawfulness of the actions of the Commissioner "may provide certain difficulties to the plaintiff's claim."

APPLICATION FOR REVIEW ON GROUNDS OF BIAS UNSUCCESSFUL

Case	J G Russell v the Taxation Review Authority and the Commissioner of Inland Revenue
Decision date	19 December 2008
Act	Bill of Rights Act 1990
Keywords	Judicial review, bias

Summary

The taxpayer applied to the High Court for review of the Taxation Review Authority's ("TRA") refusal to recuse himself from hearing the applicant's challenge. The applicant alleged presumptive bias resulting from the extensive history of litigation involving the applicant before the TRA. The application for review was dismissed by the High Court.

Impact of decision

A consistent pattern of judgments against a party does not amount to bias, as judges must rule in accordance with the law and are not required to ensure equality of outcomes.

Facts

This case was an application for judicial review of Judge Barber's decision (sitting as TRA) not to recuse himself from hearing the applicant's personal tax challenge in the TRA.

For the last 20 years, the applicant has appeared in the TRA as both advocate and witness in his clients' tax disputes relating to the use of the 'Russell Template'. Of 82 cases in which the applicant was involved, 65 were heard by Judge Barber. Judge Barber is now presiding over the applicant's personal tax challenge. Mr Russell made an application for Judge Barber to recuse himself, claiming presumptive bias on the basis of the extensive history of template litigation and the fact that Judge Barber has consistently held against him. Judge Barber declined the application and Mr Russell applied for judicial review of that decision, outlining many of the findings against him or his clients.

Counsel for the Commissioner argued that the TRA had been most helpful to the applicant as a lay litigant, and had made findings in favour of him as well as against. The Commissioner also pointed out that Judge Barber's decisions had been upheld by appellate courts on almost every occasion.

Decision

Justice Cooper dismissed the application, observing (at paragraph 99) that the "position apparently adopted in the United States was that there cannot be reasonable questions about a Judge's impartiality arising simply from his or her determination of cases even if there was a consistent pattern of holding against one party".

His Honour went on to state that an approach whereby bias is judged by equality of outcomes would be inconsistent with the judicial oath and the principle that cases must be decided in accordance with the law. His Honour held that there cannot be presumptive bias where the rulings of the Judge were in accordance with the law, and observed that a fair-minded observer would be expected to know that much about the role of a Judge.

COMMISSIONER'S RIGHT TO REMOVE AND COPY ELECTRONIC INFORMATION

Case	Avowal Administrative Attorneys Limited and Ors v the District Court at North Shore and the Commissioner of Inland Revenue
Decision date	22 December 2008
Act	Tax Administration Act 1994 ("the TAA")
Keywords	Commissioner's right to access and remove documents, electronic

Summary

The High Court held that the definition of "book and document" in the TAA included computer hard drives. The Commissioner therefore had the right to remove hard drives for copying under section 16 of the TAA. This decision should be read together with the interim judgment released on 28 February 2008.

Impact of decision

This decision explains the scope of the Commissioner's section 16 powers. It clarifies when and to what extent the Commissioner is required to do a relevance check prior to removing electronic documents for copying, particularly in circumstances involving privilege claims or encryption of hard drives.

Facts

On 8 November 2006, the Commissioner and the Australian Tax Office ("the ATO") conducted simultaneous access operations on both sides of the Tasman. The operations followed a request by the ATO to the Commissioner in 2004 under Article 26 of the Australia–New Zealand Double Tax Agreement ("the DTA"). The ATO provided background information which indicated that a number of entities based in or operating in New Zealand were promoting, marketing and implementing a wide range of tax avoidance schemes.

Using his powers under section 16 of the TAA, the Commissioner entered seven premises, both private and commercial, and removed hardcopy documents and hard drives for copying. Seven applicants commenced judicial review proceedings against the Commissioner, and another applicant later joined the proceedings.

Decision

Are hard drives a "book or document"?

The Court stated that the definition of "book and document" in the TAA was a wide one and not limited to the information contained within the book or document. Information can be stored electronically; tapes, discs and computer reels are examples within the TAA definition of information stored electronically.

A hard drive is an integral part of a computer. When reference is made to information stored on a computer, it must include information stored on a hard drive. The function of storing information on a computer that was formerly carried out by computer reels is now carried out by the hard drive. The definition of "books and documents" is out of date to the extent that it refers to computer reels. "Computer reels" in the definition must now be read as "hard drive", so the hard drive of a computer is a "book or document" for the purposes of the Act. Therefore, section 16 of the TAA authorises IRD officers to inspect and copy hard drives which they consider necessary and relevant, and section 16B authorises the removal of the hard drive to make copies, or the removal of the computer if the hard drive cannot be readily removed.

Privilege

At the Avowal sites, a blanket claim to privilege was made over all electronic information. The IRD officers considered that it would not be appropriate to conduct a relevance search because of the privilege claim. The Court stated that this was a cautious approach to take, but not one for which the IRD officers could be criticised.

Where there is a blanket claim to privilege, an officer exercising a search power may look at a document, including a document over which privilege is claimed, for the purpose of determining whether it may be relevant or privileged. However, the IRD officers cannot be criticised for deciding not to challenge the claim to privilege in these circumstances, particularly given that provision is made in section 20(5) of the TAA for a process to determine privilege claims. The copying of privileged material is not a breach of privilege where such a process is provided.

The purpose of the keyword search (relevance check) is to protect the occupier's rights against unreasonable search, to ensure that the search is directed at relevant material and to ensure that it is conducted reasonably. However privilege is also an important right. It was not unreasonable for the IRD officers to accept the claim to privilege and to deal with it in a manner consistent with section 20(5) of the TAA, rather than insisting on conducting a keyword search. In the circumstances of the particular search, the general claim to privilege meant that the IRD officers were not required to carry out a relevance check before copying and/or removing the hard drives.

At the Tauranga site, privilege was claimed over all hardcopy and electronic documents that were to be removed. The officer in charge instructed his team to scan the material solely to determine whether or not it was relevant and nothing else. As noted above, the Court considered that this did not breach privilege.

Ability to copy the entire hard drive

The applicants submitted that once a relevance search was done, only the documents identified as relevant could be copied off the hard drive. The Court rejected this submission, holding that while it may have been technically possible for the IRD computer technicians to have done this, as a matter of principle, this approach is not required by the authorities. The fact that the hard drive may also contain irrelevant or privileged information does not mean that it cannot be copied or removed.

What is required is an assessment by the IRD officers in relation to each hard drive copied, first to determine whether there is relevant material on it and second whether it is necessary to copy that material so that it can be removed for later analysis.

Encryption

At the Motueka sites, four of the hard drives copied were encrypted. The IRD computer technician did not conduct a keyword search of these computers. The applicants submitted that the IRD could not copy or remove an encrypted file because no relevance check could be done on that file. The Court rejected the submission. It stated that the purpose of the relevance check was to provide a balance between the ability of the Commissioner to exercise his section 16 powers and the rights of the individual to be free from unreasonable search and seizure.

The Court stated that the encryption of a hard drive made a relevance check pointless. The Court held that the ultimate test was whether the inspection was conducted in a reasonable fashion and whether the search and decision to copy was a reasonable one, having regard to all the circumstances of the case. The decision must be made on the basis that copying is necessary or relevant or considered likely to provide relevant information. The conclusion that the encrypted hard drives were likely to provide information for the purposes of the investigation was reasonable. Therefore, it was open to the IRD officers to copy or remove the encrypted hard drives.

Prior to the final hearing, the applicants indicated that they were withdrawing their challenge to the removal of hard copy documents and to the removal of electronic information at three of the seven sites.

Of the four sites at which the removal of electronic information was challenged, the High Court upheld the Commissioner's actions at the Avowal and Tauranga sites. At the Browns Bay site, the Court ordered the return of a back-up hard drive over which no relevance check was carried out, but upheld the copying of a laptop. At the Motueka site, the Court ordered the return of the laptop clone and the second hard drive, but upheld the copying of the encrypted hard drive.

SUMMARY JUDGMENT APPLICATION FOR GST REFUND

Case	Sadiqs as Trustees of Azura Family Trust
Decision date	17 December 2008
Act	Goods and Services Tax Act 1985, Tax Administration Act 1994
Keywords	Refund

Summary

The plaintiffs failed in their application for a refund for their February GST return, and the Commissioner had given notice of his intention to investigate within 15 days.

Impact of decision

Confirms that a screen dump letter generated is not proof of service.

Facts

A family trust entered into an agreement to purchase several pieces of property from Westham Holdings Limited ("Westham") for $13 million. The trust was registered for GST and held itself as developers.

On 28 February 2005, the trust filed GST returns for a refund of $1.6 million. GST returns were also filed for the periods March, April and May 2005 for refunds of various amounts in respect of the same purchase. The total GST claim for refund was about $2,667,762.16

The plaintiffs as trustees of the trust commenced legal action in the High Court for the GST refund under section 46 (1) of the GST and applied for summary judgment.

The main issue in the summary judgment application was whether there was a notice issued by the Commissioner within the 15 days from the day after the GST return of 28 February 2005 was received, informing the plaintiffs that their claim was being investigated. At issue were the following letters:

a. The dump screen letter of 5 April 2005.

b. The faxed letter of 14 April 2005.

Decision

Letter of 5 April 2005

The Judge held that there was no evidence to suggest that the said letter was sent to the plaintiffs or their tax agent.

Letter of 14 April 2005

However the Judge held there was no challenge by the plaintiffs to the letter of 14 April 2005. Moreover, the letter was properly served by fax under section14 of the Tax Administration Act 1994 and consent to service by fax could be inferred from the plaintiffs' conduct under section 16(2)(b) of the Electronic Transactions Act 2002.

Accordingly, the Judge dismissed the plaintiffs' claim for summary judgment on the GST return for 28 February 2005

GST returns for March, April and May 2005

The Judge went on to consider the plaintiffs' claim for the other periods and found the position was unclear as both parties had approached the case on the basis of whether the Commissioner had served his notice in reply to the GST return for February.

Directions were made for parties to file further affidavit and amendments to address the other periods.

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