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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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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.

Ref	Draft type/title	Description/background information
INS0006	Fines and penalties – income tax deductibility	This draft interpretation statement considers whether taxpayers are allowed an income tax deduction for fines and penalties imposed on them or their employees or contractors, and concludes that taxpayers are not allowed income tax deductions for fines and penalties. This is the case whether the fines and penalties are imposed on them or their employees or on an independent contractor.

Livestock valuation determinations to move to LTS Technical Standards

From 1 July 2009 the responsibility for issuing livestock determinations passed from the Office of the Chief Tax Counsel (OCTC) to Legal & Technical Services. From that date LTS Technical Standards assumed responsibility for issuing the National Standard Costs for Specified Livestock and the National Average Market Values for Specified Livestock.

These changes mean that from 1 July 2009 onwards any enquiries relating to livestock valuations should be sent to:

LTS Manager
LTS Technical Standards
National Office
Inland Revenue
PO Box 2198
Wellington 6140

IN SUMMARY

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Where an assessment has been issued after the Commissioner has declined to accept a taxpayer's NOR as valid, the taxpayer should proceed to challenge proceedings to dispute the validity of the Notice of Response.

Court of Appeal says omission to act can be aiding or abetting 50

The Court of Appeal upheld the High Court decision and confirmed that an omission by a director to do an act can mean that the director aided the company to offend.

High Court considers issue when a dividend is paid 51

The Court held that crediting a dividend to the shareholders' accounts was sufficient to constitute payment, whether or not those funds were at the disposal of the shareholders.

Relitigated decision of the Authority 52

In this proceeding the Commissioner sought to strike out the disputant's claim on the basis that this matter had already been before the Authority and decided upon by it.

Questions we've been asked

QB 09/04: The relationship between section 113 of the Tax Administration Act 1994 and the proviso to section 20(3) of the Goods And Services Tax Act 1985 when a registered person has not claimed an input tax deduction in an earlier taxable period 53

While the Commissioner is not prevented from exercising the discretion under section 113, the Commissioner's practice is generally not to do so. This is because the proviso to section 20(3) provides a specific mechanism by which taxpayers can correct the failure to claim the input tax deduction themselves.

QB 09/05: Residential investment property or properties in Australia owned by New Zealand resident – NRWT treatment of interest paid to Australian financial institution 55

This QWBA clarifies Inland Revenue's position on whether New Zealand residents who borrow money from Australian financial institutions to purchase residential investment properties in Australia are liable for non-resident withholding tax (NRWT) on the interest payable.

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**

DECISION NOT TO REISSUE RULINGS – BR PUB 03/08: MARINE FARMING LEASES AND SECONDHAND GOODS INPUT TAX CREDITS; AND, BR PUB 03/09: MARINE FARMING LICENCES AND SECONDHAND GOODS INPUT TAX CREDITS

The following public rulings applied from 12 November 2003 to 12 November 2006:

- BR Pub 03/07: *Fishing quota and secondhand goods input tax credits*
- BR Pub 03/08: *Marine farming leases and secondhand goods input tax credits*
- BR Pub 03/09: *Marine farming licences and secondhand goods input tax credits*
- BR Pub 03/10: *Coastal permits, certificates of compliance, marine farming permits, and secondhand goods input tax credits*.

These four rulings, along with the combined commentary, were published in *Tax Information Bulletin* Vol 15, No 12 (December 2003).

The issue addressed by BR Pub 03/08 and BR Pub 03/09 was whether GST input tax credits were available to GST-registered persons who acquired marine farming leases or licences from GST-unregistered persons.

Section 10 of the Aquaculture Reform (Repeals and Transitional Provisions) Act 2004 provides that from 1 January 2005 marine farming leases and licences are deemed to be coastal permits granted under the Resource Management Act 1991. This includes marine farming leases and licences in existence before 1 January 2005. Therefore, marine farming leases and licenses are now covered by BR Pub 09/05: *Coastal permits and certificates of compliance – secondhand goods input tax credits*. For that reason, the rulings relating to marine farming leases and licences (BR Pub 03/08 and BR Pub 03/09) will not be reissued.

In addition, marine farming permits are no longer required because section 67J of the Fisheries Act 1983 was repealed by section 19 of the Aquaculture Reform (Repeals and Transitional Provisions) Act 2004. As a result, those parts of BR Pub 03/10 relating to marine farming permits do not form part of the reissued ruling – BR Pub 09/05.
BR Pub 09/05 continues to apply to coastal permits and certificates of compliance.

PRODUCT RULING BR PRD 09/03

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Laws

This Ruling applies in respect of:

- section DA 2(4) of the Income Tax Act 2007;
- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Income Tax Act 2007; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of people ("Drivers") by Reach Media to transport unaddressed mail (newspapers, leaflets, brochures, catalogues, advertising material, samples and other such items) from Reach Media's premises to pre-determined drop-off locations.

The Drivers will not be transporting any item the carriage of which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.

The Drivers are engaged pursuant to a standard form contract. Further details of the Arrangement are as follows.

1. The parties to the Arrangement are:
    - Reach Media: a company that carries on the business of delivering unaddressed mail to New Zealand households; and
    - Drivers: people who use their own vehicles to transport unaddressed mail from Reach Media's premises to pre-determined drop-off locations.
2. Reach Media also contracts, although they are not parties to the Arrangement:
    - distributors: people who deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand; and
    - supervisors: people who are responsible for overseeing the distributors and for performing certain administration functions relating to the delivery of unaddressed mail.
3. Reach Media has processing branches throughout the country. A network of distributors and Drivers delivers circulars. A network of supervisors manages the distributors. The Drivers, distributors and supervisors are paid on a "piece rate" basis. In the case of the Drivers, this is under the Contract for Services to Perform Driver Delivery Services of Papers and Circulars ("the Contract").
4. Under the heading "Services", the Contract requires the Drivers to:
    - complete the services set out in Schedule 1 of the Contract;
    - ensure other business commitments do not affect their obligations to Reach Media; and
    - comply with tax and health and safety legislation.
5. Schedule 1 of the Contract requires Drivers to collect particular items within a specified period from Reach Media's premises and transport those items to pre-determined drop-off locations.
6. Schedule 1 specifies the services for which the Drivers are contracted.
    - The Driver is engaged to deliver the delivery material to the contracted distributors in a defined area and complete related tasks.
    - The services Drivers are to perform are the collection of stock, physical delivery of individual items, and physical return of surplus stock.
7. Under the heading "Equipment", the Contract states that the Drivers are responsible for providing their own equipment (such as personal office supplies, a telephone, a vehicle and wet weather gear) at their own expense. The Drivers are also responsible for ensuring that such equipment is well maintained, safe and fit for purpose.
8. Schedule 2 specifies the fees Reach Media is to pay the Drivers. They are the only amounts payable in respect of the services and are inclusive of all taxes (except GST) and other duties and levies.
9. Each Driver's fee for undertaking the services for Reach Media is calculated under Schedule 2 at a rate determined by the volume of deliveries.
10. Under the heading "Payment", the Contract specifies that Reach Media will provide a draft invoice to Drivers twice a month. The Drivers must check the invoice and advise Reach Media of any errors. Payment is made by direct credit within seven days.

11. Under the heading "Taxation", the Contract specifies that the Drivers are responsible for the payment of their own taxes on payments made to them by Reach Media under the Contract. Reach Media may be required to withhold taxes from its payments. If so, the payment made will be reduced to the extent that tax is withheld.
12. Under the heading "Termination of Contract", the Contract states that Reach Media or the Drivers may terminate the contract for any reasons whatsoever by giving four weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice.
13. Under the heading "Status of Contractor", the Contract defines the contractor's status as follows.
    - Reach Media engages the Driver under a contract for services, so the Driver is an independent contractor. The terms of the contract or its operation do not create an employment relationship between the Driver and Reach Media. These statements in the Contracts are referred to in this Ruling as the "Clarification Statements".
    - The Driver may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.
14. Under the heading "No Liability", the Contract states that the Driver is to undertake the services at their own risk. This means Reach Media will not be liable to the Driver (or any other person) for any loss resulting from the Driver's deliberate actions or negligence or where there is a breach of any term of this contract.
15. Under the heading "Delivery Options", the Contract states that the Driver is responsible for arranging for someone else to carry out the services if the Driver is unable to work. The Driver is solely responsible for payment and all other obligations to others who help them in this way.
16. Under the heading "Frequency of Deliveries", the Contract states that Reach Media does not guarantee any minimum amount of material for which the Driver will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions.

a) The Contract entered into between Reach Media and the Drivers is the same as that provided to the Inland Revenue Department in the Ruling application dated 8 July 2008, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses.

b) The relationship between Reach Media and the Driver is, and will continue to be during the period this Ruling applies, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

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

- For the purposes of the PAYE rules, any payment Reach Media makes to a Driver pursuant to the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in sections RD 5, RD 7 and RD 8 respectively of the Income Tax Act 2007.
- For the purpose of section DA 2(4) of the Income Tax Act 2007, any payment Reach Media makes to a Driver pursuant to the Contract will not be "income from employment".
- For the purposes of the GST Act, the provision of services by any Driver under the Contract will not be excluded from the definition of "taxable activity" in section 6 of the GST Act, by section 6(3)(b) of the GST Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2008 and ending on 30 June 2012.

This Ruling is signed by me on the 20th day of April 2009.

Ross Baxter

Acting Sector Manager, Assurance – Large Enterprises

PRODUCT RULING BR PRD 09/04

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Laws

This Ruling applies in respect of:

- section DA 2(4) of the Income Tax Act 2007;
- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Income Tax Act 2007; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of people ("Country Supervisors") by Reach Media to provide certain supervisory services in country areas in relation to the delivery of unaddressed mail (newspapers, leaflets, brochures, catalogues, advertising material, samples and other such items).

The Country Supervisors will not be delivering any item the carriage of which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.

The Country Supervisors are engaged pursuant to a standard form contract. Further details of the Arrangement are as follows.

1. The parties to the Arrangement are:
   - Reach Media: a company that carries on the business of delivering unaddressed mail to New Zealand households; and
   - Country Supervisors: people who are, or are to be, contracted by Reach Media to provide certain supervisory services in country areas in relation to the delivery of unaddressed mail.
2. Reach Media also contracts, although they are not parties to the Arrangement:
   - drivers: people who use their own vehicles to deliver the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations; and
   - distributors: people who deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand.
3. Reach Media has processing branches throughout the country. A network of distributors and drivers delivers circulars. A network of supervisors manages the distributors. The drivers, distributors and supervisors are paid on a "piece rate" basis. In the case of the Country Supervisors, this is under the Contract for Services to Supervise Delivery of Papers and Circulars ("the Contract").
4. Under the heading "Services", the Contract requires Country Supervisors to:
   - complete the services set out in Schedule 1 of the Contract;
   - ensure other business commitments do not affect their obligations to Reach Media; and
   - comply with tax and health and safety legislation.
5. Schedule 1 of the Contract requires Country Supervisors to prepare for and oversee the delivery of material by distributors in a defined area.
6. Schedule 1 specifies the services for which the Country Supervisors are contracted.
   - Country Supervisors are engaged as contractors to oversee the delivery of material to the contracted distributors in a defined area and complete related tasks.
   - The services Country Supervisors must perform are the processing of stock, the overseeing of the physical delivery of individual items, and administration and customer services.
7. On occasion, the Country Supervisors will also perform delivery services of the type that would otherwise be performed by Distributors and receive a piece rate payment for performing such services. Such a situation is not recorded in writing in the Contract but instead represents an oral variation of the Contract.
8. While Country Supervisors also sign contracts with Distributors on behalf of Reach Media, these contracts are still between Reach Media and the Distributor.
9. Under the heading "Equipment", the Contract specifies that the Country Supervisors are responsible for providing their own equipment at their own expense, such as personal office supplies, a telephone, a vehicle and wet weather gear. The Country Supervisors are also responsible for ensuring that such equipment is well maintained, safe and fit for purpose.
10. Schedule 2 of the Contract specifies the fees Reach Media will pay to the Country Supervisors. Subject to any oral variation of the type described in paragraph 7, these are the only amounts payable by Reach Media in

respect of the services of the Country Supervisors and are inclusive of all taxes (except GST) and other duties and levies.

11. Each Country Supervisor's fee for undertaking services for Reach Media is calculated under Schedule 2 of the Contract at a rate determined by the volume of deliveries.
12. Under the heading "Payment", the Contract provides that Reach Media will provide the Country Supervisors with a draft invoice twice a month. The Country Supervisors must check the invoice and advise Reach Media of any errors. Payment is made by direct credit within seven days.
13. Under the heading "Taxation", the Contract specifies that the Country Supervisors are responsible for paying their own taxes on payments Reach Media makes to them under the Contract. Reach Media may be required to withhold taxes from its payments. If so, the payment made will be reduced to the extent that tax is withheld.
14. Under the heading "Termination of Contract", the Contract states that Reach Media or the Country Supervisors may terminate the contract for any reason by giving four weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice.
15. Under the heading "Status of Contractor", the Contract defines the contractor's status as follows.
    - Reach Media engages the Country Supervisor under a contract for services, so the Country Supervisor is an independent contractor. The terms of the contract or its operation do not create an employment relationship between the Country Supervisor and Reach Media. These statements in the Contract are referred to in this Ruling as the "Clarification Statements".
    - The Country Supervisor may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.
16. Under the heading "No Liability", the Contract states that the Country Supervisor undertakes the services at their own risk. This means Reach Media will not be liable to the Country Supervisor (or any other person) for any loss resulting from the Country Supervisor's deliberate actions or negligence or where there is a breach of any term of this contract.
17. Under the heading "Delivery Options", the Contract states that the Country Supervisor is responsible for arranging for someone else to carry out the services if the Country Supervisor is unable to work. The Country Supervisor is solely responsible for payment and all other obligations to others who help them in this way.
18. Under the heading "Frequency of Deliveries", the Contract states that Reach Media does not guarantee any minimum amount of material for which the Country Supervisor will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions.

a) The Contract entered into between Reach Media and the Country Supervisors is the same as that provided to the Inland Revenue Department in the Ruling application dated 8 July 2008, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses.

b) The relationship between Reach Media and the Country Supervisor is, and will continue to be during the period this Ruling applies, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

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

- For the purposes of the PAYE rules, any payment Reach Media makes to a Country Supervisor pursuant to the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in sections RD 5, RD 7 and RD 8 respectively of the Income Tax Act 2007.
- For the purpose of section DA 2(4) of the Income Tax Act 2007, any payment Reach Media makes to a Country Supervisor pursuant to the Contract will not be "income from employment".
- For the purposes of the GST Act, the provision of services by any Country Supervisor under the Contract will not be excluded from the definition of "taxable activity" in section 6 of the GST Act, by section 6(3)(b) of the GST Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2008 and ending on 30 June 2012.

This Ruling is signed by me on the 20th day of April 2009.

Ross Baxter

Acting Sector Manager, Assurance – Large Enterprises

PRODUCT RULING BR PRD 09/05

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Laws

This Ruling applies in respect of:

- section DA 2(4) of the Income Tax Act 2007;
- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Income Tax Act 2007; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of people ("Distributors") by Reach Media for the physical delivery by the Distributors of unaddressed mail to households and other premises throughout New Zealand.

The Distributors will not be transporting any item the carriage of which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.

The Distributors are engaged pursuant to a standard form contract. From 1 February 2008 until 31 July 2008, Distributors were engaged under the contract provided to the Inland Revenue Department on 8 July 2008 ("the Initial Contract"). From 1 August 2008, the Distributors were engaged under the contract provided to the Inland Revenue Department on 17 December 2008 ("the Revised Contract"). The two contracts are referred to throughout as "the Contracts". Further details of the Arrangement are set out as follows.

1. The parties to the Arrangement are:
   - Reach Media: a company that carries on the business of delivering unaddressed mail to New Zealand households; and
   - Distributors: people who are, or are to be, contracted by Reach Media to deliver unaddressed mail.
2. Reach Media also contracts, although they are not parties to the Arrangement:
   - drivers: people who use their own vehicles to deliver the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations; and
   - supervisors: people who are responsible for overseeing the Distributors and perform certain administration functions relating to the delivery of unaddressed mail.
3. Reach Media has processing branches throughout the country. A network of Distributors and drivers delivers circulars. A network of supervisors manages the Distributors. The drivers, Distributors and supervisors are paid on a "piece rate" basis. In the case of the Distributors this is under the Contract for Services – Distribution Contractor.
4. Under the heading "Deliveries", the Contracts state that the Distributor agrees to deliver in accordance with Schedule 1 of the Initial Contract and Schedule 2 of the Revised Contract. Distributors must:
   - use reasonable care when making deliveries;
   - ensure other commitments do not affect their obligations to Reach Media; and
   - comply with tax and health and safety legislation.
5. The Contracts require Distributors to deliver to every letterbox at every house or flat in the area given to them.
6. The Contracts specify that the Distributors are responsible for doing the deliveries at a time they choose, within the time-frames Reach Media communicates.
7. Under the heading "Delivery Equipment", the Contracts state that the Distributors are responsible for providing their own delivery equipment (such as bags, vehicles, footwear and wet weather gear) at their own expense. The Distributors are also responsible for ensuring that such equipment is well maintained, safe and fit for purpose.
8. The Contracts specify the fees Reach Media will pay the Distributors. They are the only amounts payable by Reach Media in respect of the services and are inclusive of all taxes (except GST) and other duties and levies.
9. Each Distributor's fee for undertaking the services for Reach Media is calculated under the Contracts at a rate determined by the volume of deliveries.
10. Under the heading "Payment", the Contracts provide that Reach Media will provide to the Distributors a draft

invoice twice a month. The Distributors must check the invoice and advise Reach Media of any errors. Payment is made by direct credit within seven days.

11. Under the heading "Taxation", the Contracts specify that the Distributors are responsible for paying their own taxes on payments Reach Media makes to them under the Contract. Reach Media may be required to withhold taxes from its payments. If so, the payment made will be reduced to the extent that tax is withheld.

12. Under the heading "Termination of Contract", the Contracts state that Reach Media or the Distributors may terminate the contract for any reason by giving two weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Initial Contract or the Revised Contract, then Reach Media may terminate the relevant Contract immediately without notice.

13. Under the heading "Status of Contractor", the Contracts define the contractor's status as follows.

    - The Distributor is engaged by Reach Media under a contract for services, so the Distributor is an independent contractor. Terms of the contract or its operation do not create an employment relationship between the Distributor and Reach Media. These statements in the Contracts are referred to in this Ruling as the "Clarification Statements".
    - The Distributor may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.

14. Under the heading "No Liability" in the Initial Contract and "Liability" in the Revised Contract, the Contracts state that the Distributor is to undertake the services at their own risk. This means Reach Media will not be liable to the Distributor (or any other person) for any loss resulting from the Distributor's deliberate actions or negligence or where there is a breach of any term of this contract.

15. Under the heading "Delivery Options", the Contracts state that the Distributor is responsible for arranging for someone else to carry out the Distributor's services if the Distributor is unable to work. The Distributor is solely responsible for payment and all other obligations to others who help them in this way.

16. Under the heading "Frequency of Deliveries", the Contracts state that Reach Media does not guarantee any minimum amount of material for which the Distributor will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions.

a) The Contracts entered into between Reach Media and the Distributors are the same as those provided to the Inland Revenue Department in the Ruling application dated 8 July 2008 and on 17 December 2008, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses.

b) The relationship between Reach Media and the Distributor is, and will continue to be during the period this Ruling applies, in accordance with all of the material terms of the Contracts.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

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

- For the purposes of the PAYE rules, any payment Reach Media makes to a Distributor pursuant to the Contracts will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in sections RD 5, RD 7 and RD 8 respectively of the Income Tax Act 2007.
- For the purpose of section DA 2(4) of the Income Tax Act 2007, any payment Reach Media makes to a Distributor pursuant to the Contracts will not be "income from employment".
- For the purposes of the GST Act, the provision of services by any Distributor under the Contracts will not be excluded from the definition of "taxable activity" in section 6 of the GST Act, by section 6(3)(b) of the GST Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 01 July 2008 and ending on 30 June 2012.

This Ruling is signed by me on the 20th day of April 2009.

Ross Baxter

Acting Sector Manager, Assurance – Large Enterprises

PRODUCT RULING BR PRD 09/06

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Laws

This Ruling applies in respect of:

- section DA 2(4) of the Income Tax Act 2007;
- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Income Tax Act 2007;
- section 6(3)(b) of the Goods and Services Act 1985 ("GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of people ("Metro Supervisors") by Reach Media to provide certain supervisory services in metropolitan areas in relation to the delivery of unaddressed mail (newspapers, leaflets, brochures, catalogues, advertising material, samples and other such items).

The Metro Supervisors will not be supervising the delivery of any item the carriage of which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.

The Metro Supervisors are engaged pursuant to a standard form contract.

Further details of the Arrangement are as follows.

1. The parties to the Arrangement are:
   - Reach Media: a company that carries on the business of delivering unaddressed mail to New Zealand households;
   - Metro Supervisors: people who are, or are to be, contracted by Reach Media to provide certain supervisory services in metropolitan areas in relation to the delivery of unaddressed mail.
2. Although not parties to the Arrangement, Reach Media also contracts :
   - drivers: people who use their own vehicles to deliver the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations;
   - distributors: people who deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand.
3. Reach Media has processing branches throughout New Zealand. Circulars are delivered by a network of distributors and drivers. These distributors are managed by a network of supervisors. The drivers, distributors and supervisors are paid on a "piece rate" basis. In the case of the Metro Supervisors this is under the Contract for Services to Supervise Delivery of Papers and Circulars ("the Contract").
4. Under the heading "Services", the contract requires Metro Supervisors to:
   - complete the services set out in Schedule 1 of the Contract;
   - ensure their other business commitments do not affect their obligations to Reach Media;
   - comply with relevant tax and health and safety legislation.
5. Schedule 1 requires Metro Supervisors to prepare for and oversee the delivery of material by distributors in a defined area.
6. Schedule 1 specifies the services for which the Metro Supervisors are contracted.
   - Metro Supervisors are engaged as contractors to oversee the delivery of material by the contracted Distributors in a defined area and to complete related tasks.
   - The services Metro Supervisors are to perform are to oversee the physical delivery of individual items, administration and customer services.
7. On occasion the Metro Supervisors will also perform delivery services of the type that would otherwise be performed by Distributors and receive a piece rate payment for performing such services. Such a situation is not recorded in writing in the Contract but instead represents an oral variation of the Contract.
8. While Metro Supervisors also sign contracts with Distributors on behalf of Reach Media, these contracts are still between Reach Media and the Distributor.
9. Under the heading "Equipment", the Contract states that Metro Supervisors are responsible for providing their own equipment (such as personal office supplies, a telephone, vehicles and wet weather gear) at their own expense. The Metro Supervisors are also responsible for ensuring such equipment is well maintained, safe and fit for purpose.
10. Schedule 2 specifies the fees Reach Media is to pay Metro Supervisors. Subject to any oral variation of the type described in paragraph 7, these are the only amounts payable by Reach Media in respect of the services provided by the Metro Supervisors and are

inclusive of all taxes (except GST) and other duties and levies.

11. Each Metro Supervisor's fee for undertaking the services for Reach Media is calculated under Schedule 2 at a rate determined by the volume of deliveries.
12. Under the heading "Payment", the Contract specifies that Reach Media will provide the Metro Supervisors with a draft invoice twice a month. The Metro Supervisors must check the draft invoice and advise Reach Media of any errors. Payment is made by direct credit within seven days.
13. Under the heading "Taxation", the Contract specifies that the Metro Supervisors are responsible for paying their own taxes on payments Reach media makes to them under the Contract. Reach Media may be required to withhold taxes from its payments. If so, the payment made will be reduced to the extent that tax is withheld.
14. Under the heading "Termination of Contract", the Contract states that Reach Media or the Metro Supervisors may terminate the contract for any reasons by giving four weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice.
15. Under the heading "Status of Contractor", the Contact defines the contractor's status as follows.
    - Reach Media engages the Metro Supervisor under a contract for services, so the Metro Supervisor is an independent contractor. The terms of the contract or its operation do not create an employment relationship between the Metro Supervisor and Reach Media. These statements in the Contracts are referred to in this Ruling as the "Clarification Statements".
    - The Metro Supervisor may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.
16. Under the heading "No Liability", the Contract states that Metro Supervisors are to undertake the services at their own risk. This means Reach Media will not be liable to the Metro Supervisor (or any other person) for any loss resulting from their deliberate actions or negligence or where there is a breach of any term of this contract.
17. Under the heading "Delivery Options", the Contract states that the Metro Supervisor is responsible to arrange for someone else to carry out the services if the Metro Supervisor is unable to work. The Metro Supervisor is solely responsible for payment and all other obligations to anyone who helps them in this way.
18. Under the heading "Frequency of Deliveries", the Contact states that Reach Media does not guarantee any minimum amount of material for which the Metro Supervisor will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The Contract entered into between Reach Media and the Metro Supervisors are the same as that provided to the Inland Revenue Department in the Ruling application dated 8 July 2008, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses.

b) The actual relationship between Reach Media and the Metro Supervisor is, and will continue to be during the period this Ruling applies, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

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

- For the purposes of the PAYE rules, any payment made to a Metro Supervisor by Reach Media pursuant to the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in sections RD 5, RD 7 and RD 8 respectively of the Income Tax Act 2007.
- For the purpose of section DA 2(4) of the Income Tax Act 2007, any payment made to a Metro Supervisor by Reach Media pursuant to the Contract will not be "income from employment".
- For the purposes of the GST Act, the provision of services by any Metro Supervisor under the Contract will not be excluded from the definition of "taxable activity" in section 6 of the GST Act, by section 6(3)(b) of the GST Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2008 and ending on 30 June 2012

This Ruling is signed by me on the 20th day of April 2009.

Ross Baxter

Acting Sector Manager, Assurance – Large Enterprises

PUBLIC RULING BR PUB 09/03: CHARITABLE ORGANISATIONS AND FRINGE BENEFIT TAX

Note (not part of the ruling): This ruling is essentially the same as public ruling BR Pub 00/08 published in *Tax Information Bulletin* Vol 12, No 9 (September 2000). BR Pub 00/08 was a reissue of Public Ruling Pub 97/6 which was published in *Tax Information Bulletin* Vol 9, No.5 (May 1997). This Ruling has been updated to take into account the Income Tax Act 2007 and reaches the same conclusion as the earlier rulings, despite the legislative changes that have occurred since the earlier rulings expired.

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

Taxation Law

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

This Ruling applies in respect of section CX 25.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a non-monetary benefit by a charitable organisation, other than a benefit by way of short-term charge facilities as described in section CX 25(2) and (3), to an employee of that organisation.

In this Ruling, the term "charitable organisation" has the meaning that it has in the Act for the purposes of the fringe benefit tax (FBT) rules; that is, in relation to any quarter or (where FBT is payable on an income year basis under section RD 60) any income year, any association, fund, institution, organisation, society, or trust to which section LD 3(2) or schedule 32 applies. A local authority, a public authority, or a university are not "charitable organisations" for the purposes of section CX 25 and are therefore excluded from this fringe benefit exemption.

How the Taxation Law applies to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

- For the purposes of section CX 25(1), a fringe benefit is not provided by a charitable organisation, if a non-monetary benefit is received by an employee of the organisation mainly in connection with employment in an activity that either:
  - carries out any of the organisation's benevolent, charitable, cultural, or philanthropic purposes; or
  - does not constitute a profession, a trade, or an undertaking that is carried on for profit.
- For the purposes of section CX 25(1), a fringe benefit is provided by a charitable organisation, if a non-monetary benefit is received by an employee of the organisation mainly in connection with employment in an activity that:
  - cannot be characterised as carrying out any of the organisation's benevolent, charitable, cultural, or philanthropic purposes; and
  - constitutes a profession, a trade, or an undertaking that is carried on for profit (even if that profit is to be applied solely for the purposes of the charitable organisation).
- For the purposes of section CX 25(1), a non-monetary benefit that is provided to an employee of a charitable organisation is received by an employee "mainly in connection with" their employment in a business activity outside of the organisation's benevolent, charitable, cultural, or philanthropic purposes, if:
  - the employee is employed solely in the business activity of the organisation; or
  - the employee is employed in both the business activity and in activities related to the charitable purpose of the organisation, and the benefit arises mainly in connection with the employment in the business activity; or
  - the employee is employed in both the business activity and in activities related to the charitable purpose of the organisation, the benefit arises equally in connection with both the business and non-business activities, and the employee is predominantly employed in the business activities of the employer.

The period or income year for which this Ruling applies

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

This Ruling is signed by me on 30 June 2009.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 09/03

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 09/03 ("the Ruling").

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

Overview

1. Benefits provided by charitable organisations to their employees are excluded from being fringe benefits by section CX 25. The exclusion does not apply, however, to any benefit that is provided mainly in connection with an employee's employment in a business activity that is outside the organisation's benevolent, charitable, cultural, or philanthropic purposes. The exclusion also does not apply to benefits provided to an employee by way of short-term charge facilities if the value of those benefits in a tax year is more than 5% of the employee's salary or wages for the tax year.

2. The issues that the Ruling addresses are when:
    - an activity will be a business activity that is outside the organisation's benevolent, charitable, cultural, or philanthropic purposes; and
    - a benefit will be received by an employee mainly in connection with such activities.

Legislation

3. Section CX 25 states:

CX 25 Benefits provided by charitable organisations

When not fringe benefit

(1) A charitable organisation that provides a benefit to an employee does not provide a fringe benefit except to the extent to which—

(a) the employee receives the benefit mainly in connection with their employment; and

(b) the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.

When employer provides charge facilities

(2) Subsection (1) does not apply, and the benefit provided is a fringe benefit, if a charitable organisation provides a benefit to an employee by way of short-term charge facilities and the value of the benefit from the short-term charge facilities for the employee in a tax year is more than 5% of the employee's salary or wages for the tax year.

Meaning of short-term charge facilities

(3) For the purposes of the FBT rules, a **short-term charge facility** means an arrangement that—

(a) enables an employee of a charitable organisation to obtain goods or services that have no connection with the organisation or its operations by buying or hiring the goods or services or charging the cost of the goods or services to an account; and

(b) places the liability for some or all of the payment for the goods or services on the organisation; and

(c) is not a fringe benefit under section CX 10.

4. "Business" is defined in section YA 1 as including:

any profession, trade, or undertaking carried on for profit.

5. "Charitable organisation" is defined in section YA 1:

charitable organisation—

(a) means, for a quarter or an income year, an association, fund, institution, organisation, society, or trust to which section LD 3(2) (Meaning of charitable or other public benefit gift) or schedule 32 (Recipients of charitable or other public benefit gifts) applies—

(i) in the quarter; or

(ii) in the income year, if fringe benefit tax is payable on an income year basis under section RD 60 (Close company option); and

(b) does not include a local authority, a public authority, or a university.

6. Section LD 3(2) states:

LD 3 Meaning of charitable or other public benefit gift

…

Description of organisations

(2) The following are the entities referred to in subsection (1)(a):

(a) a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand:

(b) a public institution maintained exclusively for any 1 or more of the purposes within New Zealand set out in paragraph (a):

(bb) a Board of Trustees that is constituted under Part 9 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(bc) a tertiary education institution that is established under Part 14 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(c) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:

(d) a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a).

7. Schedule 32 lists certain named organisations that are "recipients of charitable or other public benefit gifts". It should be noted that the application of the exclusion from fringe benefit tax applies to a wider category of organisations (including those listed in schedule 32) than the stricter requirements for organisations to be registered under the Charities Act 2005. Section CX 25(1) applies to those organisations that are commonly referred to as "donee organisations" for the donations tax credit available under section LD 1.

8. "Charitable purpose" is defined in section YA 1 as including:

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

9. The Act does not define what is meant by benevolent, cultural, or philanthropic purposes.

Application of the Legislation

Business activities outside an organisation's benevolent, charitable, cultural, or philanthropic purposes

10. Benefits provided by charitable organisations to their employees are excluded from being fringe benefits by section CX 25. Section CX 25(1) states that the exclusion does not apply, however, to any benefit that is provided mainly in connection with an employee's employment in a business activity that is outside the organisation's benevolent, charitable, cultural, or philanthropic purposes. The first issue to be considered, therefore, is when an activity undertaken by a charitable organisation will be a business activity that is outside of the organisation's benevolent, charitable, cultural, or philanthropic purposes.

11. "Business" is defined in section YA 1 as including "any profession, trade, or undertaking carried on for profit".

12. The Court of Appeal in *Grieve v CIR* (1984) 6 NZTC 61,682 considered that underlying the use of the word "business" in the context of a taxation statute is the fundamental notion of the exercise of an activity in an organised and coherent way that is directed to an end result – the making of pecuniary profits. The Court said that the existence of a business activity is determined on the basis of the nature of the activity and whether the taxpayer has the intention of making a pecuniary profit in carrying out that activity. The Court stated (at p 61,691):

> Statements by the taxpayer as to his intentions are of course relevant but actions will often speak louder than words. Amongst the matters which may properly be considered in that inquiry are the nature of the activity, the period over which it is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity, and the financial results.

13. Many charitable organisations engage in activities on a continuous and ongoing basis, commit time, money, and effort to those activities, and conduct a large volume of transactions, so will have these characteristics of a business.

14. The issue is therefore whether a charitable organisation that budgets for, and has a record of making surpluses of income over expenditure has the "intention of making a profit". If it is carried on for profit, it will be a "business" for the purposes of the Income Tax Act.

15. English cases have held that the fact that a charity makes a profit does not mean that it is carried on "for profit". In *Trustees of the National Deposit Friendly Society v Skegness* UDC [1958] 2 All ER 601, the House of Lords found that a charity's objects are to advance the charitable purposes for which it is established. If profit-making is not one of their purposes but is only a means of achieving those purposes, the charity is not carried on "for profit". In *Customs and Excise Commissioners v Bell Concord Educational Trust Ltd* [1989] 2 All ER 217, the Court held that the question of whether or not an organisation is carried on "for profit" must be answered by reference to the objects for which that organisation is established, as contained in its constitution, and not by reference to the budgeting policy of that organisation.

16. Thus, a charitable organisation that carries on its activities in a business-like manner and which has the intention and record of making surpluses is not carried on "for profit", unless the organisation's constitution states that one of its purposes is to make a profit. As such organisations are not carried on "for pecuniary profit"; they are not carrying on a "business" for the purposes of the Income Tax Act and the FBT exemption.

17. For the purposes of section CX 25, however, it is only benefits provided in connection with business activities that fall outside the organisation's benevolent, charitable, cultural, or philanthropic purposes that

will be fringe benefits. Once an activity is identified, applying the test outlined in Grieve that an activity undertaken by a charitable organisation is a business activity, the issue is whether the activity is outside of the organisation's benevolent, charitable, cultural, or philanthropic purposes.

18. A distinction between the charitable (ie, running and administering a charity and providing charitable services) and the non-charitable purposes of a charity was drawn in *Oxfam v City of Birmingham District Council* [1975] 2 All ER 289 (HL).

19. *Oxfam v City of Birmingham District Council* concerned section 40 of the United Kingdom General Rate Act 1967, which applied to premises or heriditaments that were occupied by a charity and wholly or mainly used for charitable purposes. The House of Lords considered whether Oxfam's gift shops were on premises wholly or mainly used for charitable purposes. The House of Lords found that, although the gift shops were used for purposes that indirectly related to the achievement of the objects of the charity (ie, selling donated goods to raise money for the charity), the premises were not wholly or mainly used for charitable purposes.

20. In reaching this conclusion, the House of Lords drew a line between the use of premises for purposes that are the charitable purposes of the charity and the use of premises for purposes that, though purposes of the charity, are not charitable purposes. Lord Cross said (at p 293):

> The wording of s 40(1) of the [General Rate Act 1967] shows that the Legislature did not consider that the mere fact that a hereditament in question is occupied by a charity justifies any relief from rates. That is only justified if the hereditament is being used for the "charitable purposes" of the charity. So the first question which arises is: what are the 'charitable purposes' of a charity as distinct from its other purposes? The answer must be, I think, those purposes or objects the pursuit of which make it a charity—that is to say in this case the relief of poverty, suffering and distress.

21. As well as "those purposes or objects the pursuit of which make it a charity" Lord Cross recognised that activities that are "wholly ancillary to" or "directly facilitate" the carrying out of an organisation's charitable objects will be considered to be part of fulfilling the organisation's charitable objects.

22. Activities involved in carrying out the charitable objects of a charitable organisation or directly facilitating the carrying out of the charitable objects (such as administrative or clerical activities) will be within the benevolent, charitable, cultural, or philanthropic purposes of the organisation for the purposes of section CX 25. However, trading activities carried on to raise funds for the charity that are not themselves the charitable purposes of the charity will not be within the benevolent charitable, cultural, or philanthropic purposes of the organisation for the purposes of section CX 25, even if all funds raised from the activity are applied to the charity's purpose.

23. The distinction between an organisation carrying out the functions for which the organisation was established and an organisation carrying on a business was examined in *Port Chalmers Waterfront Workers Union v CIR; New Zealand Waterfront Workers Union v CIR* (1995) 17 NZTC 12,059 (High Court); (1996) 17 NZTC 12,523 (Court of Appeal). That case concerned section 61(23) of the Income Tax Act 1976. Section 61(23) (section CW 44 of the Income Tax Act 2007) provides an exemption from income tax for the income of a friendly society, except so far as that income is derived from business carried on beyond the circle of its membership.

24. In *Port Chalmers*, the High Court drew a distinction between a friendly society carrying on a business as a trading organisation and a friendly society discharging its functions as a friendly society. It said that where the friendly society is discharging its functions as a friendly society, it is not carrying on a business even though it may conduct transactions that have a commercial flavour. This distinction was accepted by the Court of Appeal.

25. The Ruling interprets section CX 25(1) as drawing a similar distinction as that drawn in *Port Chalmers* between the activities of a charitable organisation which discharge the purposes for which the organisation was established (ie, the discharging of its charitable, benevolent, or philanthropic objects) and the charitable organisation carrying on a business as a trading organisation. A charitable organisation is not carrying on a business for the purposes of section CX 25(1) when it discharges its charitable objects, even though it may discharge those purposes in a business-like manner.

26. The effect of the Ruling is that the activities involved in carrying out the charitable objects of a charitable organisation, or directly facilitating the carrying out of the charitable objects (such as fundraising or administrative or clerical activities) will not be treated as being business activities for the purposes of section CX 25(1). However, trading activities which are carried on to raise funds for the charity, and which are not themselves the charitable purposes of the charity,

will be treated as business activities of the charitable organisation, if they satisfy the "business" test set out in the Income Tax Act (ie, those activities are carried on for the purpose of making a pecuniary profit).

27. Thus, when a charitable organisation's employees are engaged in carrying out the charitable purposes of the organisation, benefits provided to them will not attract fringe benefit tax (FBT) liability because of section CX 25 (unless the benefits are provided by way of short-term charge facilities). However, when a charitable organisation's employees are engaged in activities of the organisation that are not in themselves charitable and that constitute business activities of the organisation, any benefits provided to them will not fall within the exclusion provided by section CX 25, so will attract FBT liability where applicable.

"Mainly in connection with"

28. The second issue arising is when a benefit will be treated as being received by an employee "mainly in connection with" business activities that fall outside a charitable organisation's benevolent charitable, cultural, or philanthropic purposes. It is necessary to consider this issue because an employee may be employed by a charitable organisation in a range of activities, some of which relate to the carrying out of the organisation's charitable purposes or other non-business activities of the organisation, and some of which are non-charitable business activities. It is only benefits provided "mainly in connection with" the non-charitable business activities that fall outside of the exclusion provided in section CX 25.

29. The expired ruling BR Pub 00/08 was issued in the context of section CI 1(m) of the Income Tax Act 1994, which is the equivalent provision to section CX 25. This section used the words "primarily and principally" where section CX 25 uses "mainly".

30. Lord Morton of Henryton discussed the meaning of the word "mainly" in *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 (at p 639):

> The word "mainly" at once gives rise to difficulties. Probably it means **"more than half"**.
>
> [Emphasis added]

31. This meaning was accepted in *CIR v Mitchell* (1986) 8 NZTC 5,181 where Davison CJ, after stating that he regarded "mainly" as the best synonym for "principally", held that for a room to be "principally" used in connection with carrying on the employment of the taxpayer, the employment-related use of the room must be "greater than the total of all other uses". This equates to the room being used for employment purposes more than half the time.

32. The *Concise Oxford English Dictionary* (11th ed, revised) defines "primarily" and "principally" as follows:

> **Primarily:** for the most part; mainly
>
> **Principally:** for the most part; chiefly

33. Therefore, based on the cases discussed above and the dictionary definitions, it is considered that the replacement of the phrase "primarily and principally" with "mainly" does not change the meaning of the provision.

34. The change of the phrase "primarily and principally" to "mainly" occurred as a result of the rewrite of the Income Tax Act. This change is discussed in *Tax Information Bulletin* Vol 16, No 5 (June 2004) (at p 71):

> *Mainly*
>
> The rewritten provisions use "mainly" in place of "primarily and principally" and similar expressions. The expression "primarily and principally" was considered by Eichelbaum J in *Newman Tours Ltd v CIR* (1989) 11 NZTC 6,027 (High Court). The judge interpreted the expression as requiring that the purpose not only be the main one, in the sense of outweighing all the other purposes, singly or collectively, but also the primary one—that is, the first one. Sufficiently similar connotations can be conveyed in the single word "mainly".

35. This reasoning supports the above conclusion that "mainly" conveys a similar meaning to "primarily and principally".

36. A benefit will be provided to an employee of a charitable organisation mainly in connection with employment in a non-charitable business activity of the organisation if the benefit arises primarily in connection with such a business activity. If an employee is employed only in a non-charitable business activity of a charitable organisation, then any benefits provided to that employee will be provided mainly in connection with employment in a non-charitable business activity. If an employee is employed both in activities relating to the charitable purpose of the organisation and in non-charitable business activities, it will be necessary to determine which activity the benefit arises primarily in relation to.

37. If a benefit arises equally in connection with both the business and non-business activities carried out by an employee, the benefit will be provided mainly in connection with the activity in which the employee is predominantly employed.

38. Section CX 25(1) excludes benefits provided by charitable organisations from being fringe benefits except "to the extent to which" the benefits are provided mainly in connection with employment in a non-charitable business activity of the organisation. The use of "to the extent to which" does not, in this instance, mean that a benefit should be apportioned.

39. In the context of section CX 25(1) what must be considered is the scope of the employee's involvement in the business activities of the employer. The term "to the extent that" combined with the requirement of "mainly" is directed at making a comparison (as opposed to contemplating apportionment, as in other contexts within the Act, for example, section DA 1 of the Income Tax Act 2007 which uses a similar phrase – "to the extent to which"). This comparison is necessary to determine whether the benefit is in connection with the employee's employment in the business or charitable activities or both. Where such benefits are not mainly due to the employer's business activities then the benefit is not a fringe benefit.

40. In summary, if a benefit is provided mainly in connection with employment in a non-charitable business activity of an organisation, then the entire benefit will be a fringe benefit – it will not be apportioned between its relation to charitable activities and non-charitable business activities. This is because the use of the word "mainly" in the section is inconsistent with the concept of apportionment; rather "mainly" means that where the requirement is for the most part true for that element, the section is satisfied completely. There is no need for an apportionment, so in the context of section CX 25 the phrase "to the extent to which" is to be interpreted as meaning "where".

Organisations to which the Ruling does not apply

41. The Ruling does not apply to employers that are local authorities, public authorities, or universities. These organisations are excluded from the definition of "charitable organisation" for the purposes of the FBT rules, so the charitable organisation exclusion contained in section CX 25 does not apply to them. Benefits provided by these organisations will be subject to FBT unless some other exclusion or limitation applies to them.

The Ruling does not apply to short-term charge facilities

42. As previously stated the exclusion from being a fringe benefit provided under section CX 25(1) does not apply to the provision of short-term charge facilities in specified circumstances. Section CX 25(2) states that a fringe benefit will be provided if a charitable organisation provides a benefit to an employee by way of a short term charge facility and the value of the benefit is more than 5% of the employee's salary and wages for a tax year. Subsection (3) defines the term "short-term charge facility". Example 6, set out below, illustrates this point.

Period of Ruling

43. This ruling commences on the first day of the 2008/09 income year. The previous ruling expired on 30 June 2004. Given the terms of section 91C of the Tax Administration Act 1994, it is not possible to issue a ruling in respect of the Income Tax Act 1994 or Income Tax Act 2004 for the period from 1 July 2004 to the end of the 2007/08 income year. However, the Commissioner is of the view that the same principles and conclusions as set out in this Ruling apply in respect of any benefits provided to employees by charitable organisations during this period.

Examples

43. Some activities will usually be characterised as being within the charitable objectives of an organisation. Examples of such activities include:

- appeals for funds for the charity's purpose;
- passive investment and management of the funds of the charity, as long as the charitable organisation does not carry on a business of fund investment; and
- the administration of the above activities.

44. It will be a question of fact in each case whether other activities of a charitable organisation are activities that are not inherently charitable activities that the organisation was established to carry out. It is, therefore, possible that two organisations may carry out similar activities, with different FBT consequences for each organisation. An example of this is the sale of goods or services for valuable and adequate consideration on a similar basis to business enterprises carried on by non-charitable entities and with a view to making a profit. This type of activity would generally be considered to be outside an organisation's charitable objectives, although in some situations such an activity would fall within their charitable objectives. Examples of such cases could include if the production or provision of the goods or services served the purpose of creating job opportunities for a group that the organisation was established to assist, or if the goods or services were provided at low cost to a group that the organisation was established to assist.

45. The examples that follow provide further guidance as to when charitable organisations will and will not be liable for FBT on benefits provided to employees.

Example 1

46. A charitable organisation has the principal purpose of providing education through a private school. The organisation is a charitable organisation for the purposes of the FBT rules, because it is not carried on for the private pecuniary profit of any individual and its funds are applied wholly or principally for charitable purposes (ie, the advancement of education) within New Zealand.

47. The organisation charges tuition fees and has had surpluses of income over expenditure for the last three income years. It provides a car to its school principal for work and private use.

48. The organisation is not liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the principal. This is because the benefit is provided by a charitable organisation to an employee who is employed in respect of the charitable organisation carrying out its charitable purposes. The employee is not employed in a separate business activity carried on by the school.

Example 2

49. The charitable organisation from example 1 also conducts a farming business on land adjacent to the school. The farming operation is carried out in a business-like manner for the purpose of the practical component of the school's agricultural courses. The organisation provides a car to its farm manager for work and private use.

50. The organisation is not liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the farm manager. This is because the farm manager is employed in respect of the charitable organisation carrying out its charitable purposes (ie, the advancement of education). As the farming business falls within the charitable purposes of the organisation, it is not significant that the farm is run in a business-like manner.

Example 3

51. This example has the same facts as example 2, except the farming operation is carried out in a business-like manner for the purpose of making a profit that is applied to the promotion of the organisation's charitable purposes. The farm is not used to educate students at the school.

52. In this situation the organisation is liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the farm manager. This is because the farm manager is employed in respect of a business activity that falls outside the charitable purposes of the organisation. It is not significant that the profit that is made from the farming activity is applied to the promotion of the organisation's charitable purposes.

Example 4

53. A charitable organisation has the principal purpose of relieving poverty by running a food bank. The organisation is a charitable organisation for the purposes of the FBT rules, because it is not carried on for the private pecuniary profit of any individual and its funds are applied wholly or principally for charitable purposes (ie, the relief of poverty) within New Zealand. The organisation also runs a shop that sells office supplies (purchased from a wholesaler) to the public. The profit made from the shop is used to purchase food for the food bank.

54. The organisation has a policy of providing low interest loans to employees who work in the food bank. The loans are not available to those whose employment consists solely of working in the shop. Peter works for the organisation three days a week in the shop and two days a week in the food bank. He receives a low interest loan from the organisation.

55. The charitable organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. This is because the benefit arises in relation to Peter's employment in the food bank, which is a charitable activity of the organisation. It does not matter that the majority of Peter's employment with the organisation is in a non-charitable business activity of the organisation, because the benefit does not arise in relation to this activity.

Example 5

56. This example has the same facts as example 4, except the low interest loans are available to all employees of the organisation.

57. In this situation the organisation is liable for FBT on the benefit arising from the provision of the low interest loan to Peter. As the low interest loans are available to all employees of the organisation, the benefit arises in relation to both Peter's employment in the charitable activities of the organisation and his employment in the non-charitable business activities of the organisation. As Peter is predominantly employed in the non-charitable business activities of the organisation, the benefit arises "mainly in connection with" those activities.

Example 6

58. A charitable organisation employs a secretary at its head office whose employment involves administrative matters relating to the running of the organisation. The secretary's salary is $40,000 for the tax year. On top of the salary, the organisation provides the secretary with a fuel card for use at a local petrol station. The fuel card is in the organisation's name and the organisation is liable to pay any amounts charged to the card. The secretary uses the card to obtain $80 worth of petrol every week.

59. The organisation is liable for FBT on the benefit arising from the provision of the fuel card to the secretary, even though the secretary is employed in respect of the charitable organisation carrying out its charitable purposes (administrative work at an organisation's head office "directly facilitates" the carrying out of an organisation's charitable purposes). The reason the organisation is liable for FBT in this situation is that the benefit is provided by way of a short-term charge facility and the value of the benefit is more than 5% of the secretary's salary or wages for the tax year. The benefit, therefore, is a fringe benefit under section CX 25(2).

BR PUB 09/04: FISHING QUOTA – SECONDHAND GOODS INPUT TAX CREDITS; AND, BR PUB 09/05: COASTAL PERMITS AND CERTIFICATES OF COMPLIANCE – SECONDHAND GOODS INPUT TAX CREDITS

Note (not part of the ruling): BR Pub 09/04 and BR Pub 09/05 are essentially the same as public rulings BR Pub 03/07 and BR Pub 03/10, which were published with BR Pub 03/08 and BR Pub 03/09 in *Tax Information Bulletin* Vol. 15, No 12 (December 2003).

The four previous rulings expired on 12 November 2006. It was considered appropriate to issue four separate rulings with a shared commentary given the different nature of the different marine farming authorisations and fishing quota. BR Pub 03/08 and BR Pub 03/09 on marine farming leases and licences respectively will not be reissued, because marine farming leases and licences are now deemed to be coastal permits granted under the Resource Management Act 1991. Marine farming permits (previously covered by BR Pub 03/10) are no longer required under section 67J of the Fisheries Act 1983, which was repealed in 2004. Therefore, the reissued rulings do not consider marine farming permits.

BR Pub 03/07 and BR Pub 03/10 have been updated to take into account changes to the Fisheries Act 1983, the Fisheries Act 1996, and the Resource Management Act 1991, and the enactment of the Foreshore and Seabed Act 2004. No changes to these Acts, nor the enactment of the Foreshore and Seabed Act 2004, affect the conclusions reached in these rulings.

The reissued rulings consider whether a secondhand goods input tax credit can be claimed on the purchase of fishing quota, coastal permits, or certificates of compliance.

The rulings conclude that secondhand goods input tax credits cannot be claimed on such purchases. A single commentary applies to BR Pub 09/04 and BR Pub 09/05. Both rulings apply until 30 June 2014.

PUBLIC RULING BR PUB 09/04: FISHING QUOTA – SECONDHAND GOODS INPUT TAX CREDITS

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

Taxation Laws

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

This Ruling applies in respect of section 20(3), the definitions of "goods" and "secondhand goods" in section 2, and the definition of "input tax" in section 3A.

Definitions

For the purposes of this ruling, "fishing quota" means –

a) individual transferable quota that has been granted under the Fisheries Act 1983; or

b) individual transferable quota that has been granted under the Fisheries Act 1996; or

c) annual catch entitlements that have been generated by individual transferable quota under section 66 of the Fisheries Act 1996.

The Arrangement to which this Ruling applies

The Arrangement to which this Ruling applies is the supply of fishing quota. The supply of fishing quota must satisfy the following conditions:

1. The supply by the vendor is a supply made by way of sale.
2. The supply is not a taxable supply.
3. The supply is made to the purchaser, who is a GST-registered person.
4. The fishing quota is situated in New Zealand at the time of supply.
5. The fishing quota is acquired for the principal purpose of making taxable supplies.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Fishing quota is not a good in accordance with the definition of "goods" in section 2. As a result, fishing quota will not constitute "secondhand goods" for the purposes of the Act.
- The purchaser of such fishing quota will not be entitled under section 20(3) to deduct from the amount of output tax payable in a taxable period any amount of input tax in respect of the supply of the fishing quota.

The period for which this Ruling applies

This Ruling applies to a supply of fishing quota where the time of the supply occurs or occurred at any time during the period 13 November 2006 to 30 June 2014.

This Ruling is signed by me on 26 June 2009.

Susan Price

Director, Public Rulings

PUBLIC RULING BR PUB 09/05: COASTAL PERMITS AND CERTIFICATES OF COMPLIANCE – SECONDHAND GOODS INPUT TAX CREDITS

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

Taxation Laws

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

This Ruling applies in respect of section 20(3), the definitions of "goods" and "secondhand goods" in section 2, and the definition of "input tax" in section 3A.

Definitions

For the purposes of this ruling—

- "coastal permit" means a resource consent in the form of a coastal permit granted under the Resource Management Act 1991; and
- "certificate of compliance" means a certificate of compliance granted under the Resource Management Act 1991.

The Arrangement to which this Ruling applies

The Arrangement to which this Ruling applies is the supply of a:

- coastal permit; or
- certificate of compliance.

The supply of a coastal permit or certificate of compliance must satisfy the following conditions:

1. The supply by the vendor is a supply made by way of sale.
2. The supply is not a taxable supply.
3. The supply is made to the purchaser, who is a GST-registered person.
4. The coastal permit or certificate of compliance is situated in New Zealand at the time of supply.
5. The coastal permit or certificate of compliance is acquired for the principal purpose of making taxable supplies.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- A coastal permit or certificate of compliance is not a good in accordance with the definition of "goods" in section 2. As a result, the coastal permit or certificate of compliance will not constitute "secondhand goods" for the purposes of the Act.
- The purchaser of a coastal permit or certificate of compliance will not be entitled under section 20(3) to deduct from the amount of output tax payable in a taxable period any amount of input tax in respect of the supply of the coastal permit or certificate of compliance.

The period for which this Ruling applies

This Ruling applies to a supply of a coastal permit or a certificate of compliance where the time of the supply occurs or occurred at any time during the period 13 November 2006 to 30 June 2014.

This Ruling is signed by me on 26 June 2009.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 09/04 and BR PUB 09/05

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Rulings BR Pub 09/04 and BR Pub 09/05 ("the rulings").

Summary

Individual transferable quota and annual catch entitlements cannot be categorised as usufruct rights, sales of goods coupled with a licence, or profits à prendre. Individual transferable quota and annual catch entitlements have to be regarded as unique property rights, with their characteristics determined from the provisions of the fishing legislation. Individual transferable quota and annual catch entitlements are personal property, however, these rights are choses in action. Therefore individual transferable quota and annual catch entitlements are not "goods", and therefore not "secondhand goods", for the purposes of the Goods and Services Tax Act 1985.

Coastal permits and certificates of compliance are not personal or real property but are unique statutory rights created under the Resource Management Act 1991. Therefore, coastal permits and certificates of compliance are not "goods", and therefore not "secondhand goods", for the purposes of the Goods and Services Tax Act 1985.

Background

BR Pub 09/04 and BR Pub 09/05 consider whether a GST input tax credit is available to registered persons who acquire fishing quota or coastal permits and certificates of compliance from unregistered persons. While this commentary considers both fishing quota and coastal permits and certificates of compliance, fishing quota need to be dealt with separately from coastal permits and certificates of compliance because different statutory requirements exist for each. Before looking at the relevant GST legislation, the natures of fishing quota and coastal permits and certificates of compliance need to be considered.

Fishing quota

The fishing quota being considered are individual transferable quota and annual catch entitlements as defined in section 2 of the Fisheries Act 1996.

Individual transferable quota were established and allocated in 1986 under the Fisheries (Quota Management Areas, Total Allowable Catches, and Catch Histories) Notice 1986, which was issued under the Fisheries Act 1983. They appear to have been allocated based on a person's commercial fishing history. No charge was made for the quota initially allocated. Individual transferable quota does not provide a "free" right, however, because an annual levy must be paid. These levies are typically significant.

The annual catch entitlement was introduced under the Fisheries Act 1996, and section 66 of that Act provides that the annual catch entitlement is generated by the individual transferable quota at the beginning of each fishing year. Section 74 provides that the annual catch entitlement confers the immediate right to catch fish in a given year. Section 132 and 133 provide that the individual transferable quota and annual catch entitlement may be transferred.

Individual transferable quota and annual catch entitlements are not the same, but they are both unique statutory rights that may be bought, sold and, in the case of individual transferable quota, may have interests registered against them. Even though annual catch entitlements are generated from individual transferable quota and are separate property rights, this commentary will use the term "fishing quota" to refer to both rights for the sake of convenience.

While most fishing quota are held by large organisations, individual fishers hold some small parcels of fishing quota. Some of these fishers may not make supplies in excess of $60,000 in a 12-month period ($40,000 prior to 1 April 2009), so are not required to register for GST under section 51 of the Goods and Services Tax Act 1985. One of these non-registered fishers may sell their fishing quota (individual transferable quota or annual catch entitlements) to a person who is registered for GST. The question arises as to whether the purchaser may claim a GST input tax credit.

Nature of fishing quota

There is no definitive statement in any of the fisheries legislation as to the nature of fishing quota. The expression "individual transferable quota" was not defined in the Fisheries Act 1983. While the term is defined in the Fisheries Act 1996, the definition appears to have been added to ensure all quota allocated under the different Acts are regarded as fishing quota for the purposes of the Fisheries Act 1996.

The change between the Fisheries Act 1983 and Fisheries Act 1996 appears to have affected the characteristics that could be ascribed to fishing quota. Under the 1983 Act, the fundamental rights acquired by the holder of fishing quota (as determined from the legislation) were that the quota holder had the right to catch and take away for their own purposes:

- a specified quantity
- of a particular fish species
- from a particular area (the quota management area)
- in a specific period (in a year, although a quota is issued in perpetuity).

These rights could be dealt with in ordinary commercial dealings; they could be bought and sold, used as security, and have interests registered against them.

The nature of individual transferable quota granted under the Fisheries Act 1983 has been considered in court decisions. Under the 1983 Act the individual transferable quota granted the right to fish rather than the right to receive annual catch entitlements. The Court of Appeal considered the nature of fishing quota in *New Zealand Fishing Industry Association (Inc) v Minister of Fisheries* 22 July 1997, CA 82/97. The case involved the judicial review of a decision made by the Minister of Fisheries to reduce the total allowable commercial catch for snapper in quota management area 1. The Court of Appeal made various comments regarding the nature of fishing quota. Tipping J stated (at page 16):

> While quota are undoubtedly a species of property and a valuable one at that, the rights inherent in that property are not absolute. They are subject to the provisions of the legislation establishing them. That legislation contains the capacity for quota to be reduced. If such reduction is otherwise lawfully made, the fact that quota are a "property right", to use the appellants' expression, cannot save them from reduction. That would be to deny an incident integral to the property concerned.

The Court of Appeal confirmed that individual transferable quota are property under the Fisheries Act 1983, although the court provides little in the way of further guidance on the precise nature of individual transferable quota except to state that the characteristics of quota must be determined from the legislation.

Further clarification of individual transferable quota was provided by Baragwanath J in *Antons Trawling Co Ltd v Smith* [2003] 2 NZLR 23. In dealing with a contractual dispute, Baragwanath J stated that individual transferable quota are statutory choses in action (at paragraph 5):

> The root of title is the issue under the quota management system … of individual transferable quota (ITQ) which is a statutory chose in action comprising a fraction of the total of exclusive rights to fish commercially a particular species of fish within one of the ten quota management areas into which the exclusive economic zone is divided. Rights to ITQ are codified by the relevant legislation, especially the Fisheries Amendment Act 1986 and the Fisheries Act 1996.

This dicta, while useful, does not fully explain the rights and obligations that arise in relation to individual transferable quota, particularly in relation to the change in the nature of the entitlement under the Fisheries Act 1996. One of the major differences in relation to the rights derived by holding fishing quota is the introduction of the concept of an "annual catch entitlement". Instead of the individual transferable quota providing a right to catch a specified amount of fish, the individual transferable quota now "generates" an annual catch entitlement on the first day of the fishing year under section 67 of the 1996 Act. Fish are now generally caught under the authority of a fishing permit and an annual catch entitlement (there is also a deemed value payment procedure set out in the legislation). For holders of an individual transferable quota, the annual catch entitlement is separately tradeable, so that for a particular year a quota owner may sell their annual catch entitlement while retaining the individual transferable quota that will generate another annual catch entitlement the following year.

The lack of an in-depth judicial analysis of the nature of fishing quota in general means it is necessary to examine the characteristics and rights granted under the fisheries legislation. These can then be compared with recognised categories of property. If they are sufficiently similar, it may be appropriate to conclude that the individual transferable quota and annual catch entitlements should be regarded as belonging to that particular category. Alternatively, it may be that the most appropriate conclusion is that individual transferable quota and annual catch entitlements are not sufficiently similar to anything else and must be regarded as a separate category of property.

Several suggestions have been made as to the nature of fishing quota. The terms "usufruct right" and "profit à prendre" have been suggested to describe fishing quota. A further possibility is that a fishing quota might be regarded as the sale of goods coupled with a licence to retrieve the goods. This commentary considers these possible classifications in the following order:

- Is fishing quota a "usufruct right"?
- Is fishing quota the sale of goods coupled with a licence to remove the goods?
- Is fishing quota a "profit à prendre"?

Is fishing quota a usufruct right?

The term "usufruct right" is a civil law rather than common law term. As New Zealand's jurisprudence is based on the common law and doctrine of precedent, the term "usufruct right" is largely unknown to New Zealand law. The basis of this term in the civil law as opposed to common law is confirmed by the definition of the word "usufruct" in the *Concise Oxford English Dictionary* (11th edition, Oxford University Press, Oxford, 2006), which provides:

> **usufruct** *n*. (Roman law) the right to enjoy the use of another's property short of the destruction or waste of its substance.

A more expansive definition of the term "usufruct" is found in *Black's Law Dictionary* (8th edition, West Group, 2004):

> **usufruct** *n*. [fr. Latin *usufructis*] *Roman & civil law*. A right to use and enjoy the fruits of another's property for a period without damaging or diminishing it, although the property might naturally deteriorate over time … In modern civil law, the owner of the usufruct is similar to a life tenant, and the owner of the thing burdened is the *naked owner* …

The South African case *Geldenhuys v CIR* (1947) 14 SATC 419 provided a full judicial consideration of the nature of a usufruct right. The case concerned the assessability of an amount of income that arose from the sale of a flock of sheep. The taxpayer's husband died leaving the taxpayer with a "life interest" in her husband's estate, with their children as the ultimate beneficiaries. The flock of sheep was valued at £1,451 at the date of the husband's death. The flock declined in number after the husband's death due to drought, and a lesser number of sheep were sold for £4,941 some years later. The taxpayer used the proceeds from the sale to invest, purportedly for her own benefit. The Commissioner sought to include the difference in the taxpayer's assessable income.

The taxpayer argued that she was unable to be assessed on this amount as she was only a usufructuary in relation to the sheep. This meant she had a right only to use the sheep, with no liability for waste due to circumstances beyond her control. She accepted that this also meant the investment did not belong to her.

Steyn J (with whom Herbstein and Ogilvie Thompson AJJ agreed) delivered the leading judgment. In considering the nature of a usufruct right, Steyn J made the following observations (at page 424):

> According to some authorities … movables which are consumed or impaired (*consumuntur et minuuntur*) by use cannot be subject to a full and complete usufruct, but they can be made the subject of an incomplete usufruct, a quasi-usufruct. In this class of movables cattle and animals are, according to the authorities, included.

After referring to further texts and commentaries, Steyn J reached the following conclusions (at page 428):

> The passages from *Domat* and *Huber* which I have set out above, however, make it clear in my judgment, that with regard to the cattle and other animals to which they refer these authorities hold that the *dominium* remains with the remainderman; the usufructuary, according to the passage from *Huber* cited above having no right to sell or kill them and being obliged to restore them. … The authorities appear to be agreed that the usufructuary is only entitled to the young or progeny over and above the full complement of the flock. The full number of the flock must be maintained, the young replacing the old as they die, but the flock as an entity must be returned.

Application to fishing quota

It seems difficult to apply the concept of a "usufruct right" to fish except perhaps in a fish-farming situation. The nature of a usufruct right, even if it did apply in a New Zealand context, appears inconsistent with the characteristics of either individual transferable quota or annual catch entitlements.

A usufruct right is a right to use property without liability for waste. However, under the individual transferable quota or annual catch entitlements a person obtains the right directly or indirectly to take the relevant fish from the sea and provide these for consumption. In the case of the direct right, the owner of an annual catch entitlement is under no obligation in relation to all the other fish in the sea. Further, the owner of an individual transferable quota or an annual catch entitlement does not have to give a school of fish back at the end of the period, although it will obviously be in their best interests to manage the fisheries resources to ensure sustainability in accordance with the principles in the Fisheries Act 1996.

It is also noted that a usufruct right is typically granted for a finite period, which is consistent with the annual catch entitlement, but the individual transferable quota is granted in perpetuity. However, in neither case is there an obligation to restore fish at the end of the year or to maintain the resource generally.

The characteristics of a usufruct right are not sufficiently similar to the characteristics of either individual transferable quota or annual catch entitlements for there to be any serious possibility that either of them could be a usufruct right.

Is fishing quota the sale of goods coupled with a licence to remove the goods?

The concept of a sale of goods with a licence to remove the goods refers to a contract for the sale of goods, where a licence is granted to the purchaser to go onto land (typically the vendor's land) to get the goods. For instance, an agreement for the right to take trees from a property could be the sale of goods coupled with a licence to enter onto the land and remove the trees. Alternatively, the agreement might constitute a profit à prendre, which is discussed below.

The distinction between an agreement for the sale of goods with a licence and a profit à prendre appears to turn on whether the purchaser is obliged to take the trees, or simply may take the trees. This follows from the definition of "goods" in the Sale of Goods Act 1908. The definition provides that the term "goods" "includes emblements, growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale". Thus, unless the agreement between the parties requires that the trees shall be severed, the trees will not be goods under the Sale of Goods Act 1908.

If the purchaser **is obliged** to take the trees, then the agreement is more likely a contract for the sale of goods coupled with a licence to retrieve the trees, but if the purchaser **may** take the trees, then the agreement between the parties is more likely to be a profit à prendre.

This issue was addressed by Young J in the Supreme Court of New South Wales in *Ellison v Vukicevic* (1986) 7 NSWLR 104. The case concerned the nature of an agreement between a landowner and a quarrying company. In return for the payment of a royalty, the quarrying company was entitled to quarry for sand and sandstone on the landowner's property. In distinguishing between a profit à prendre and a contract for the sale of goods, Young J states (at page 116):

> Taking all these factors together it seems to me that the document looks more like a profit à prendre than a licence, but I must also look at the distinction between profits and sale of goods.
>
> After a considerable search, it seems to me that the most accurate statement of the law in this connection is provided by *Hinde McMorland Sim* (… at 715), where the authors say:
>
> "… profits à prendre and contracts for the sale of goods are seen as mutually exclusive, the former consist only of contracts relating to fructus naturales or other parts of the realty where the purchaser has merely a right or option to sever, while the latter consist of:

> (1) All sales of fructus industriales regardless of who is to sever them;
>
> (2) All sales of fructus naturales or other parts of the realty which are to be severed by the vendor before property passes to the purchaser; and
>
> (3) All sales of fructus naturales or other parts of the realty which the purchaser is under a contractual obligation to sever."
>
> Thus if the document puts on the purchaser an obligation to sever there is a contract for the sale of goods including a licence to go onto the land for the purpose of carrying out the contract, but if the purchaser merely has the option to sever then there is a profit à prendre.

In dealing with this issue, Young J referred to a statement in *Hinde McMorland & Sim Land Law* (Butterworths, Wellington, 1978–79). That statement still represents the view of the authors as it is included in the latest edition of *Hinde McMorland & Sim's Land Law in New Zealand* (Vol 2, LexisNexis NZ, Wellington, 2003). On the basis of this, the key distinguishing feature between a profit à prendre and a sale of goods coupled with a licence to retrieve the goods is that a profit à prendre gives rise only to an **option** to sever and take the goods, while there is an obligation to take the goods under a contract for sale.

This is consistent with the New Zealand Supreme Court decision in *Egmont Box Ltd v Registrar General of Lands* [1920] NZLR 741.

Application to fishing quota

In determining whether either individual transferable quota or annual catch entitlements could be regarded as the sale of goods coupled with a licence to remove the fish, assistance can be derived from the Fisheries Act 1983. The individual transferable quota were originally allocated without cost to fishers based on their prior catch histories. However, in order to exercise the rights under the individual transferable quota (and now the associated annual catch entitlement) the fishers must pay an annual levy.

In determining whether either individual transferable quota or annual catch entitlements is the sale of goods coupled with a licence to remove the fish, the key distinction is whether there is an obligation or merely an option to take the fish. This question appears to be answered in regulation 5(3) of the Fisheries (Cost Recovery Levies for Fisheries Services) Order 2008 (similar to now-repealed section 28ZC(3) of the Fisheries Act 1983). The regulation provides that the levy is payable by holders of individual transferable quota irrespective of whether they take the fish, aquatic life, or seaweed to which the quota relates is taken.

Given that the levy is payable regardless of whether the fish are caught in relation to the quota, individual transferable quota should not be regarded as a sale of the fish because there is no obligation to take the fish. It is also noted that the levy charged is for administering the quota management system rather than necessarily being a "price" payable for the fish. Further, the fish are not "made available" – the owner of an annual catch entitlement must still catch the fish. Thus, situations might exist where the owner of an annual catch entitlement is unable to catch the amount of the particular species for which they have an entitlement. The characteristics of a fishing quota are more consistent with the owner of an individual transferable quota or annual catch entitlement having only a right, directly or indirectly, to catch the fish. Therefore, the terms of the ownership of the individual transferable quota or annual catch entitlement are inconsistent with it being an agreement for the sale of goods.

Is fishing quota a profit à prendre?

The concept of profit à prendre has been referred to in relation to fishing quota in other contexts. The New Zealand Law Commission in "The Treaty of Waitangi and Maori Fisheries" (Preliminary Paper No 9, Wellington, 1989) referred to fishing quota in the form of individual transferable quota as being in the nature of a profit à prendre. The Law Commission stated (at paragraph 4.20):

> In economic terms the [individual transferable quota] scheme has created a new limited monopoly akin to those arising from other restrictive licensing schemes, such as liquor licences and taxi licences. In legal terms it has converted a public right to fish commercially (subject, of course, to regulation) into a series of private rights. It has created a new property right in the nature of a profit à prendre – broadly an ongoing right to take something tangible that is present on another person's land – and allocated that right to those who held, or had recently held, commercial fishing licences at the time of its commencement.

What is a profit à prendre?

The nature of a profit à prendre can be gained from the definition in "Easements and Profits à Prendre", *Halsbury's Laws of England* (vol 14, 5th ed, Butterworths, London, 2008) paragraph 254:

> A profit à prendre is a right to take something off another person's land. It may be more fully defined as a right to enter another's land and to take some profit of the soil, or a portion of the soil itself, for the use of the owner of the right. A profit à prendre is a servitude.

Profits à prendre are often contrasted with easements or licences. All three items (profits à prendre, easements and licences) confer a right to enter onto land for a particular purpose. However, the distinguishing feature of a profit à prendre is that it confers an additional right to remove something from the land. While this concept has been used in relation to rights to take trees, turf and minerals, it has also been applied to the taking of fish and other game from land.

One of the earlier cases on point is *Wickham v Hawker* [1835–42] All ER 1. The case was concerned with the nature of the right provided to an individual providing the "liberty of hawking, hunting, fishing, and fowling". The issue was whether this was a personal licence in which case it could be exercised only by the individual or whether it was a right in the nature of a profit à prendre that could be exercised by servants of the indivdual. Parke B made the following observation (at page 5):

> This being the rule of law on the subject, the point to be decided here is whether the liberty granted is a mere personal licence of pleasure, or a grant of a licence of profit – a profit à prendre. The liberty of fowling has been decided, in one case, to be a profit à prendre, and may be prescribed for as such (*Davies' Case* (1688) 3 Mod Rep 246). The liberty to hawk is one species of ancupium … the taking of birds by hawks, and seems to follow the same rule. The liberty of fishing appears to be of the same nature; it implies that the person who takes the fish, takes for his own benefit: it is common of fishing.

The conclusion of the court was that this grant of the liberty of hawking, hunting, fishing, and fowling was a profit à prendre. This decision was followed by the English Court of Appeal decision in *Fitzgerald v Firbank* [1895–9] All ER 445. This case concerned the nature of a grant of exclusive fishing rights in respect of a section of a river. The court considered the nature of the fishing rights because the defendant had polluted the river by discharging waste products from a gravel works into the river which had a significant detrimental effect on the fish in the river. The plaintiffs brought an action for an injunction to stop further pollution and for damages for the pollution to date.

The Court of Appeal decided the case in favour of the plaintiffs. The comments of the various members of the court are useful in terms of identifying the nature of the fishing rights. Lindley LJ made the following comments at page 448:

> The right of fishing includes the right to take away fish unless the contrary is expressly stipulated. I have not the slightest doubt about that. Therefore, the plaintiffs have got a right of some sort as distinguished from a mere revocable licence.
>
> What is that? It is a good deal more than an easement; it is what is commonly called a profit à prendre. It is of such a nature that a person who enjoys that right has possessory rights that he can bring an action for trespass at common law for the infringement of those rights.

Rigby LJ, in agreeing with Lindley LJ, went on to state at page 450:

> I hold that, on the incorporeal hereditament, there is a right of action against any person who disturbs them, either by trespass, or by nuisance, or in any other substantial manner.

This decision was followed by Farwell J in *Nicholls v Ely Beet Sugar Factory Ltd* [1931] All ER 154. That case concerned the plaintiff's ability to bring an action of nuisance seeking an injunction to stop the defendant polluting a river in which the plaintiff held two fishing rights. The defendant sought to defend the action by arguing that the plaintiff's title was not sufficient title to maintain the action in nuisance. The court held that the plaintiff's title, which was a profit à prendre, was sufficient to enable the plaintiff to bring an action in trespass or nuisance to protect that right.

The above cases demonstrate that a feature of a profit à prendre is the right to remove something from the land. The cases also show that the courts have applied this concept to fishing rights. Therefore, on the basis that fishing quota is a "fishing right", it is possible that either the individual transferable quota or the annual catch entitlement is a profit à prendre.

An interest in land

So far, the cases have concluded that the grant of fishing rights is generally a profit à prendre because it includes the right not only to catch the fish but also to take them away. Another important feature of a profit à prendre is identified in *Nicholls*. This feature is that a profit à prendre is considered an interest in land that, while not explicitly stated in *Nicholls*, is necessarily assumed by the parties, as the plaintiff was bringing an action of nuisance. A nuisance, according to the definition accepted by Goddard CJ in the English case *Howard v Walker* [1947] 2 All ER 197, 199:

> Nuisance is the unlawful interference with a person's use or enjoyment of land, or of some right over, or in connection with it.

That a profit à prendre is an interest in land was addressed more directly in *Webber v Lee* (1882) 9 QBD 315. This case concerned the nature of a right that had been granted over certain land to shoot game and to take it away. The plaintiff was arguing that what had been granted was a mere licence, the defendant argued that the right was a profit à prendre.

The English Court of Appeal unanimously decided that the interest was a profit à prendre and an interest in land. While all three judges delivered separate judgments, they all made statements similar to that delivered by Jessel MR (at page 318):

> The right to shoot game and to take it away when shot has been decided to be an interest in land and a profit à prendre.

One consequence of a profit à prendre being an interest in land is that a profit à prendre can be created or granted only by the owner of a sufficient estate or interest in the land. *Hinde McMorland & Sim's Land Law in New Zealand* (Vol 2, LexisNexis NZ, Wellington, 2003) states (at page 705):

> It is also necessary to ensure that the proposed grantor both has title to the product involved and has capacity as grantor if he or she owns an estate less than the fee simple.

Therefore, a profit à prendre is a right to take something off someone else's land. A profit à prendre has been held in several cases to describe certain fishing rights. Further, it is an interest in land. As it is an interest in land, the fishing rights, if they were to constitute a profit à prendre would need to be granted by a person with a legal estate in the land concerned. However, the cases considered so far have only dealt with fishing rights granted over inland waterways, being lakes, rivers, and streams. While some fishing quota are granted in respect of freshwater species, most fishing quota are granted in respect of species that live in the sea. It needs to be considered whether this makes any difference.

Can a profit à prendre exist in relation to the sea?

The principles identified in the cases considered regarding fishing rights and profits à prendre have been applied to inland waterways. The current situation also involves fishing quota granted over the open seas. The issue is whether the same principles involving profits à prendre can be applied in this instance.

Some assistance on this issue can be found in the Privy Council decision in *Attorney General for the Province of British Columbia v Attorney General for the Dominion of Canada* [1914] AC 153. This case concerned the ability of the Government of British Columbia to grant various fishing rights. The Government of the Dominion had exclusive authority over the sea coast and inland fisheries, but the Government of British Columbia had exclusive authority over property and civil rights in the province. The case concerned an area known as the "railway belt", which included non-tidal and tidal waters. The question was whether the granting of fishing rights over this area was in the domain of the Government of the Dominion or whether such rights were property rights properly in the domain of the Government of British Columbia.

The Privy Council acknowledged the distinction between tidal and non-tidal waters. Non-tidal waters are those such as lakes, rivers, and other inland waterways, excluding those parts of rivers and other waterways that meet the sea and as such are tidal. Tidal waters include those areas where non-tidal waters meet tidal waters, at the mouths of streams and in estuaries, as well as the sea coast. The open seas appear to fall into a separate category.

The Privy Council held that in respect of non-tidal waters, the right to grant fishing rights is a property right and as such exists with the owner of the underlying land. It is a private property right. In the case of rivers, title to the underlying land may be held by private individuals, but in the case of lakes, the title to the underlying land is typically reserved to the Crown. On the facts of the case, this should have meant that the Government of British Columbia had exclusive authority to grant fishing rights. However, the Government of British Columbia had specifically granted ownership of the particular land in question back to the Government of the Dominion.

The railway belt also included tidal waters. The issue was whether the principles that applied to non-tidal waters could have equal application to tidal waters. The Privy Council concluded that the same principles did not apply. In respect of the tidal waters, there was an overriding public right to fish in tidal waters, which was subject to regulation only by the Government of the Dominion. Viscount Haldane stated (at pages 167 and 168):

> The general principle is that fisheries are in their nature mere profits of the soil over which the water flows, and that title to a fishery arises from the right to the solum. A fishery may of course be severed from the solum, and then it becomes a profit à prendre in alieno solo and an incorporeal hereditament. The severance may be effected by grant or by prescription, but it cannot be brought about by custom, for the origin of such a custom would be an unlawful act. But apart from the existence of such severance by grant or prescription the fishing rights go with the property in the solum.
>
> The authorities treat this broad principle as being of general application. They do not regard it as restricted to inland or non-tidal waters. They recognise it as giving to the owners of land on the foreshore or within an estuary or elsewhere where the tide flows and reflows a title to fish in the waters over such lands, and this is equally the case whether the owner be the Crown or a private individual. But in the case of tidal waters (whether on the foreshore or in estuaries or tidal rivers) the exclusive character of the title is qualified by another and paramount title which is prima facie in the public.

From these passages, it can be seen that the Privy Council accepted the general principle that fishing rights attach to the land under the water. These rights can be severed, at which point they become profits à prendre. The Privy Council noted that the authorities had treated this general principle as applying to inland waterways as well as tidal waters. However, Viscount Haldane noted a further factor that affected the application of the principle to tidal waters: the overriding public right to fish in tidal waters.

The Privy Council noted that the nature of the public right was "not easy to define". However, the public right was regarded as paramount, which led Viscount Haldane to conclude (at page 173):

> So far as the waters are tidal the right of fishing in them is a public right subject only to regulation by the Dominion Parliament.

Therefore, while the general principle is accepted in respect of non-tidal or inland waterways, the Privy Council concluded that it does not apply in respect of tidal waters. The reason for this is that there is an overriding public right to fish in tidal waters. The Privy Council also reached the same conclusion in relation to the open seas. In specifically addressing fishing rights in waters below the mean low water mark and in the open seas, Viscount Haldane stated (at page 173):

> Their Lordships have already expressed their opinion that the right of fishing in the sea is a right of the public in general which does not depend on any proprietary title, and that the Dominion has the exclusive right of legislating with regard to it.

The effect of this is that the Privy Council rejected the application of the profit à prendre concept in respect of fishing rights relating to tidal waters and the open seas. The basis for the rejection of the profit à prendre concept in relation to fishing rights in respect of tidal waters and the open seas is the existence of an overriding public right to fish in the sea. According to the Privy Council, this title is "paramount" and subject only to regulation by Parliament.

The existence of the overriding public right to fish in the sea was a sufficient basis for the Privy Council to decide the matter in *British Columbia*. However, it is noted that even if the public right had not existed, the Privy Council would not automatically have concluded that the fishing rights were profits à prendre. As a profit à prendre is an interest in land, the person granting the fishing rights needs to have a sufficient interest in the land before the fishing right can be a profit à prendre. Therefore, before the Privy Council could have concluded that the fishing rights were profits à prendre (in the absence of the public right to fish), it would need to be established that the Crown owned the land under the sea in respect of which the fishing rights were granted. The Privy Council regarded the issue as a difficult one, and one that it considered it did not need to answer. Viscount Haldane stated (at page 174):

> But their Lordships feel themselves relieved from expressing any opinion on the question whether the Crown has a right of property in the bed of the sea below low water mark to what is known as the three-mile limit because they are of the opinion that the right of the public to fish in the sea has been well established in English law for many centuries and does not depend on the assertion or maintenance of any title in the Crown to the subjacent land.

Therefore, the particular issue of whether the Crown owns the seabed appears to be a complex issue in English law. While the Privy Council did not reach a conclusion in respect of this matter, it seems clear that the court considered it would have been relevant to a positive finding that the fishing rights were profits à prendre (although the Privy Council concluded that it was not a profit à prendre because of the overriding public right).

Application to fishing quota

In determining whether fishing quota might be in the nature of a profit à prendre, it is necessary to consider the factors established by the cases and then compare these with the individual transferable quota and annual catch entitlements.

The first characteristic of a profit à prendre is that it is a right to take something from land. The cases have held that this extends to taking fish from water that flows over land. Under the Fisheries Act 1983, fishing quota might have been argued to satisfy this requirement as being a right to take fish from water that flows over land. Under the Fisheries Act 1996, the position is less arguable. The introduction of the concept of an annual catch entitlement that is severable from the fishing quota perhaps indicates that the right to fish is one step removed from the individual transferable quota. However, given that the annual catch entitlement is generated by the individual transferable quota it is considered that individual transferable quota and the annual catch entitlement can still be regarded as ultimately giving rise to a right to take fish from water that flows over land.

The second point is that fishing quota are granted in relation to several different species. These include freshwater species (found in internal waterways) as well as deep sea species. It is considered that there is no express differentiation in the Fisheries Acts of the rights provided in relation to the different species. Accordingly, it is considered that any determination of the nature of the property rights obtained in relation to fishing quota has to apply equally to all quota across the various species.

Against this background, the Privy Council decision in *British Columbia* that an overriding public right to fish in the sea was inconsistent with the existence of a fishing right in the nature of a profit à prendre in relation to the seas poses a potential problem for the characterisation of fishing quota as a profit à prendre. The Privy Council considered that the public right was "paramount" and subject only to regulation by Parliament. The acknowledgement that this public right is subject to regulation by Parliament is important in the New Zealand context. It appears that Parliament in New Zealand has regulated the right to fish in the sea through the Fisheries Acts and associated legislation. While a public right to fish in the sea still appears to exist (with the right being limited as to the size and number of fish that may be caught), it seems clear that this is no longer an overriding public right to fish. The rights created under the quota management system now appear to be the paramount rights. The effect of this is that it is considered that the primary concern of the Privy Council in *British Columbia* does not appear to be as relevant in a New Zealand context.

The final characteristic of a profit à prendre is that it is an interest in land. This means that the profit à prendre needs to have been created by a person with a legal interest in the land. In this regard, problems may exist for fishing quota granted in respect of freshwater species. In relation to inland waterways, the owner of the adjacent land generally owns the land lying under the waterway where the waterway is contained on the land owned by the person, and to the midpoint where the waterway forms a border of the property. This principle is subject to certain exceptions where the Crown has asserted ownership of the underlying land—as may have occurred in the case of lakes and navigable rivers. Thus, the case for a fishing quota being regarded as a profit à prendre encounters difficulties in relation to fishing quota allocated in respect of freshwater species, because it is not clear whether the Crown would own all of the underlying land in question, from which it could grant an interest in land in the nature of a profit à prendre.

The situation is even more uncertain in relation to the seabed and foreshore. "Sovereign rights" are conferred on New Zealand in respect of its exclusive economic zone (comprising those areas of the sea, seabed, and subsoil that are beyond and adjacent to the territorial sea, and extending 200 nautical miles from the coast) through article 56 of the United Nations Convention on the Laws of the Sea. However, New Zealand did not ratify the convention until 19 July 1996, meaning that any fishing quota allocated between 1986 and 1996 could not have been granted by the Crown relying on the rights conferred under the convention.

In any case, in *Ngati Apa v Attorney-General* [2003] NZCA 117 (19 June 2003), the Court of Appeal held that the vesting provision in section 7 of the Territorial Sea, Contiguous Zone, and Exclusive Economic Zone Act 1977 was not sufficient to extinguish the customary title where it was found to exist. The court found that the Act was primarily concerned with sovereignty, not property rights. The title vested in the Crown was "radical title" (title acquired with the acquisition of sovereignty), which was not inconsistent with native title.

The Foreshore and Seabed Act 2004 was subsequently enacted, and expressly vested the "public foreshore and seabed", as defined under that Act, in the Crown. Section 13(1) of the Foreshore and Seabed Act 2004 provides that full legal and beneficial ownership of the "public foreshore and seabed" is vested in the Crown. The "public foreshore and seabed" as defined in that Act, extends only as far as the outer limits of the territorial sea, which remains at 12 nautical miles from the coast of New Zealand. The effect of this legislative amendment is to 'reinstate' the Crown's full ownership of the seabed of the territorial sea. However, fishing quota are granted in respect of quota management areas, which extend 200 nautical miles from the mean high water mark along the coast of New Zealand. The Foreshore and Seabed Act 2004 does not deal with the areas that extend beyond the territorial sea. Accordingly, whether the Crown owns a sufficient interest in the land from which it could grant an interest in the nature of a profit à prendre is unclear.

There are further factors from which guidance can be obtained as to whether fishing quota can be regarded as a profit à prendre. When the fisheries legislation is considered as a whole and in a wider statutory setting, it is considered that other factors support a conclusion that Parliament did not intend a fishing quota to be a profit à prendre. An example is the Forestry Rights Registration Act 1983, where Parliament specifically refers to a forestry right being a profit à prendre. The absence of a similar provision in relation to fishing quota perhaps becomes more significant. A further example is the Personal Property Securities Act 1999 where individual transferable quota and annual catch entitlements are specifically excluded from the ambit of that Act under section 23(e)(xii). While excluding fishing quota in general from an Act dealing with personal property might tend to support a conclusion that individual transferable quota and annual catch entitlements are perhaps rights that arise under a profit à prendre, an interest in land, and not personal property, the method of exclusion suggests that Parliament did not exclude them on this basis. The exclusion provisions in section 23(e) of the Personal Property Securities Act 1999 contain general exclusions for interests in land, and a specific exclusion for individual transferable quota and annual catch entitlements. If individual transferable quota and annual catch entitlements were regarded as rights that arise under a profit à prendre and an interest in land, the specific exclusion would not have been needed.

The result is that there are difficulties with individual transferable quota and annual catch entitlements being regarded as rights that arise under a profit à prendre. While there are similarities between their characteristics and the characteristics of a profit à prendre, there are also fundamental inconsistencies in the characteristics that indicate that individual transferable quota and annual catch entitlements are not rights that arise under a profit à prendre. For example, regarding fishing quota (whether individual transferable quota or annual catch entitlements) as a profit à prendre leads to difficulties in relation to individual transferable quota and annual catch entitlements allocated in respect of freshwater species because the Crown would not own all of the underlying land in question, from which it could grant an interest in land in the nature of a profit à prendre. The effect of these conclusions on the nature of individual transferable quota and annual catch entitlements leads to the possibility that individual transferable quota and annual catch entitlements are unique property rights, with the rights and obligations in respect of the property determined from the statute creating the right (as alluded to earlier).

Unique property right

The decision in *British Columbia* was cited with approval by the full High Court of Australia in *Harper v Minister for Sea Fisheries* (1989) 168 CLR 314. While this case concerned whether payments made by commercial fishers for fishing licences were a "tax", the court made useful observations regarding the nature of the Australian fishing licence system. The court noted the similarities between the rights obtained under a commercial licence and the rights obtained under a profit à prendre. However, the court concluded that the fishing rights were not profits à prendre, but instead were statutory rights created under the particular statutory regime. Mason CJ and Deane and Gaudron JJ stated (at page 325):

> The right of commercial exploitation of a public resource for personal profit has become a privilege confined to those who hold commercial licences. This privilege can be compared to a profit à prendre. In truth, however, it is an entitlement of a new kind created as part of a system for preserving a limited public natural resource in a society which is coming to recognize that, in so far as such resources are concerned, to fail to protect may destroy and to preserve the right of everyone to take what he or she will may eventually deprive that right of all context.

Conclusion on the nature of fishing quota

From the above analysis, it is concluded that individual transferable quota and annual catch entitlements are not usufruct rights nor are they the sale of goods coupled with a licence. It is noted, however, that the rights granted under the individual transferable quota and annual catch entitlements are similar to the rights that arise under a profit à prendre. The individual transferable quota generates an annual catch entitlement that provides a person with the right to take a certain amount of a certain item (being a species of fish) from a certain area. These are the basic characteristics of a profit à prendre. While the rights seem similar, the courts have held that a profit à prendre cannot exist in respect of tidal waters and the open seas, and further that only the owner of an interest in land can create a profit à prendre. As the Crown ownership of the land under the water in respect of which an individual transferable quota is granted is not completely determined and for the various other reasons considered above, it is concluded that individual transferable quota and annual catch entitlements are not profits à prendre.

The effect of this is that individual transferable quota and annual catch entitlements cannot be categorised as usufruct rights, sales of goods coupled with a licence, or profits à prendre. Individual transferable quota and annual catch entitlements have to be regarded as unique property rights, with their characteristics determined from the provisions of the fishing legislation as set out by Tipping J in *New Zealand Fishing Industry Association*. This is consistent with the Australian decision in *Harper*. It could also be seen to be consistent with the position set out by the Law Commission referred to above, where the rights are akin to, but not the same as, a profit à prendre. It also reflects the statement made by Baragwanath J in *Antons Trawling Co Ltd*.

It is noted that the general characteristics of individual transferable quota were set out in section 27 of the Fisheries Act 1996, but that section has since been repealed. It is considered that section 27 was repealed as being redundant, in that it merely summarised the characteristics found in other sections of the Fisheries Act 1996.

Coastal permits and certificates of compliance

The definition of "goods" in the Goods and Services Tax Act 1985 requires that the item concerned be either real or personal property. The nature of coastal permits and certificates of compliance needs to be considered.

Nature of a resource consent and certificate of compliance

Section 87 of the Resource Management Act 1991 defines a "resource consent" to include a consent to do something in a coastal marine area that otherwise would contravene certain provisions of the Resource Management Act and calls this kind of consent a "coastal permit". Both these terms, "resource consent" and "coastal permit" are relevant because some provisions of the Resource Management Act relate to coastal permits and some relate to the more general resource consent.

Section 88 of the Resource Management Act 1991 provides that resource consents are to be obtained from the local or regional council by application. Section 139 of the Resource Management Act provides that where an activity may be lawfully carried out without a resource consent, a certificate of compliance must be applied for instead. Section 139(6) deems a certificate of compliance to be a resource consent with the result that the provisions of the Resource Management Act are to apply accordingly. Being a "resource consent" means that the rights attaching to the resource consent are governed by section 122 of the Resource Management Act.

Section 122 of the Resource Management Act 1991 states that "a resource consent is neither real nor personal property". This statement is interesting. It is well established that all property is either real or personal property. On this basis, the only sensible interpretation that can be placed on this provision is that Parliament did not want all of the common law and other rights that would automatically attach to property of this nature to attach to resource consents. Parliament must have wanted to regulate the rights that attach to a resource consent. This is consistent with the rest of the section, which goes on to deal with the characteristics of resource consents for the purposes of other legislation. Unfortunately, there is no statement regarding the revenue Acts. The issue, therefore, is whether the statement in section 122 of the Resource Management Act 1991 applies to the Goods and Services Tax Act 1985.

Not real nor personal property

In determining whether section 122 of the Resource Management Act 1991 affects the classification of a resource consent as a "good" under the Goods and Services Tax Act 1985, several observations can be made.

The first observation is that the definition in section 122 of the Resource Management Act 1991 is not a standard definition. It is not contained in section 2 of the Resource Management Act along with all the other definitions that are prefaced with the words "for the purposes of this Act". Therefore, Parliament may well have intended section 122 to have an application wider than simply the Resource Management Act.

A second observation can be derived from the wording of section 122 of the Resource Management Act 1991. After making the initial statement that a resource consent is not real or personal property, the section provides specific exceptions where resource consents are to be regarded as having the characteristics of personal property in several specific Acts and circumstances. One of these Acts is the Personal Property Securities Act 1999. The Goods and Services Tax Act 1985 is not included as one of the exceptions in section 122.

This seems a clear indication from Parliament that the opening statement was intended to apply to the Acts that are dealt with in the section. To take the Personal Property Securities Act 1999 as an example, it seems from the plain wording of the section that Parliament intended that the opening words of the section would have meant that resource consents were not real or personal property for the purposes of that Act. This was why Parliament inserted subsection (4) to make it clear that for the purposes of that Act, it was appropriate for a resource consent to be regarded as goods within the meaning of that Act. This, however, does not make a resource consent goods or personal property for other purposes though.

On this basis, it seems that the statement in section 122 of the Resource Management Act 1991, that resource consents are neither real nor personal property, would also apply for the purposes of the Goods and Services Tax Act 1985. By not making a specific exception for the Goods and Services Tax Act, it is only possible to assume that Parliament was content with the initial statement applying to the Goods and Services Tax Act.

The third observation, which follows from the second, is that the intention of the section is apparent from the words used. By making the statement that a resource consent is neither real nor personal property, Parliament has created a legal fiction. A resource consent has the general characteristics of property, and the law has only two categorisations of that property – real and personal. Therefore, in discerning the intention of Parliament in making this statement, the most logical conclusion is that Parliament did not want the natural common law rights to attach to a resource consent that would attach as a matter of course if the resource consent were real or personal property.

It has been established that resource consents, and therefore coastal permits and certificates of compliance, are deemed not to be "personal or real property" under section 122 of the Resource Management Act 1991. It has also been established that this deeming provision operates for purposes outside the Resource Management Act and so also affects the Goods and Services Tax Act 1985. Unlike the Personal Property Securities Act 1999, the Goods and Services Tax Act is not excluded from the operation of section 122. Therefore, coastal permits and certificates of compliance are not personal or real property but, as resource consents, are statutory rights created under the Resource Management Act.

Legislation

Having established the nature of fishing quota and coastal permits and certificates of compliance, the next issue involves determining the relevant GST legislation.

Section 20 of the Goods and Services Tax Act 1985 concerns the calculation of the amount of tax payable. Section 20(1) provides that every registered person shall calculate the amount of GST payable by that person in accordance with the provisions of section 20. In relation to secondhand goods, section 20(2) requires sufficient records to be maintained of supplies of secondhand goods. Section 20 also deals with input tax deductions. In particular, section 20(3) provides that a person may deduct input tax paid in relation to the supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies, to the extent that a payment in respect of that supply has been made during that taxable period in calculating the amount of output tax payable by that person. Section 20(3) also takes account of taxpayers who operate on different accounting bases.

Under section 20(3) of the Goods and Services Tax 1985, a registered person may deduct from the amount of output tax payable, an amount of "input tax" in accordance with paragraph (a) or paragraph (b). "Input tax" is defined in section 3A. Section 3A(1)–(3) provides:

> (1) Input tax, in relation to a registered person, means
>
> (a) tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies:
>
> (b) tax levied under section 12(1) of this Act on goods entered for home consumption under the Customs and Excise Act 1996 by that person, being goods applied or acquired for the principal purpose of making taxable supplies:
>
> (c) an amount determined under subsection (3) after applying subsection (2).
>
> (2) In the case of a supply by way of sale to a registered person of secondhand goods situated in New Zealand, the amount of input tax is determined under subsection (3) if—
>
> (a) The supply is not a taxable supply; and
>
> (b) The goods are not supplied by a supplier who—
>
> (i) Is a non-resident; and
>
> (ii) Has previously supplied the goods to a registered person who has entered them for home consumption under the Customs and Excise Act 1996; and
>
> (c) The goods are acquired for the principal purpose of making taxable supplies and—
>
> (i) The taxable supplies are not charged with tax at the rate of 0% under section 11A(1)(q) or (r); or
>
> (ii) The taxable supplies are charged with tax at the rate of 0% under section 11A(1)(q) or (r) and the goods have never, before the acquisition, been owned or used by the registered person or by a person associated with the registered person.
>
> (3) The amount of input tax is—
>
> (a) if the supplier and the recipient are associated persons, the lesser of—
>
> (i) the tax included in the original cost of the goods to the supplier; and
>
> (ii) the tax fraction of the purchase price; and
>
> (iii) the tax fraction of the open market value of the supply; or
>
> (b) if the supplier and the recipient are associated persons and the supplier is deemed to have made a supply of the goods under section 5(3) that has been valued under section 10(7A), the lesser of—
>
> (i) the tax fraction of the open market value of the deemed supply under section 5(3); and
>
> (ii) the tax fraction of the purchase price; and
>
> (iii) the tax fraction of the open market value of the supply; or
>
> (c) if the supplier and the recipient are associated persons and the supplier is deemed to have made a supply of the goods under section 5(3) that has been valued under section 10(8), the lesser of—
>
> (i) the tax fraction of the valuation under section 10(8) of the deemed supply under section 5(3); and
>
> (ii) the tax fraction of the purchase price; and
>
> (iii) the tax fraction of the open market value of the supply; or
>
> (d) if the supplier and the recipient are not associated persons and the supply is not the only matter to which the consideration relates, the lesser of—
>
> (i) the tax fraction of the purchase price; and
>
> (ii) the tax fraction of the open market value of the supply; or
>
> (e) in all other cases, the tax fraction of the consideration in money for the supply.

Section 3A(1)(c) of the definition of "input tax" is the relevant provision. It refers to the calculation of input tax through subsections (2) and (3) when the supply is one of "secondhand goods". The term "secondhand goods" is defined in section 2:

> **Secondhand goods** does not include—
>
> (a) Secondhand goods consisting of any fine metal; or

(b) Secondhand goods which are, or to the extent to which they are, manufactured or made from gold, silver, platinum, or any other substance which, if it were of the required fineness, would be fine metal: or

(c) Livestock:

Section 2 also defines the term "goods":

> **Goods** means all kinds of personal or real property; but does not include choses in action, money or a product that is transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system:

Application of the legislation

The starting place to determine whether a GST input tax credit is available to a registered person is section 20(3) of the Goods and Services Tax Act 1985. Irrespective of the basis of registration, the Act provides similar tests for claiming an input tax credit in respect of supplies of secondhand goods. The claim is limited to the amount of "input tax" in relation to a supply of goods or services to that registered person, "to the extent that a payment in respect of that supply has been made during the taxable period".

The relevant definition of "input tax" is in section 3A(1)(c) of the Goods and Services Tax Act 1985. In determining the input tax under paragraph (c) it is necessary to consider subsections (2) and (3). Leaving aside the associated persons provisions (which are not relevant to the current rulings), six requirements need to be satisfied under the two subsections. These requirements are that:

(i) there be a supply by way of sale;

(ii) the supply not be a taxable supply;

(iii) the supply be made to a GST-registered person;

(iv) the supply be of secondhand goods;

(v) the secondhand goods be situated in New Zealand at the time of supply; and

(vi) the secondhand goods are acquired for the principal purpose of making taxable supplies.

Most of these requirements are specified in the rulings to ensure they will be satisfied in every instance in which the ruling applies. However, the requirement that the supply be of secondhand goods needs to be considered in detail because it cannot be specified in the rulings. Therefore, it is necessary to determine whether individual transferable quota, annual catch entitlements, coastal permits and certificates of compliance can be secondhand goods.

"Secondhand goods"

The definition of "secondhand goods" does not define the term, but prescribes a list of things that are not included in the meaning of "secondhand goods". Fishing quota, coastal permits, and certificates of compliance are not excluded under the definition. As the definition gives little indication as to what is included in the term, regard needs to be had to the ordinary meaning of "secondhand goods".

The first observation is that "secondhand goods" is a composite term. It relates to items that are first of all "goods", and then the subset of those goods that can be described as "secondhand".

"Goods"

In considering what is comprised in the term "goods", assistance can be found in section 2 of the Goods and Services Tax Act 1985. "Goods" is defined widely in the initial part of the definition, and then subjected to three specific exclusions. It includes all kinds of real and personal property, but excludes choses in action, money and electronic products (only the first of which is relevant here). Therefore, it is necessary to establish whether fishing quota, coastal permits, and certificates of compliance are real or personal property and then, whether they are choses in action.

"Property"

Before considering the "real" or "personal" aspects of property, the nature of "property" should first be established. The term "property" is not defined in the Act. "Stamp Duty", *Halsbury's Laws of England* (vol 44, 5th ed, Butterworths, London, 2008, paragraph 1,032), provides the following description of "property":

> "Property" is that which belongs to a person exclusively of others, and can be the subject of bargain and sale. It includes goodwill, trade marks, licences to use a patent, book debts, options to purchase and other rights under a contract … A revocable licence is not property. An owner of unworked minerals who gives an undertaking to the surface owner not to work them does not thereby convey property, and a grant of a purported exclusive right to carry on a certain business in an area when the grantor has no such right is not a conveyance of property.

A similar view is taken in Garrow and Fenton's *Law of Personal Property* (6th ed, Butterworths, Welington, 1998, at page 2):

> The term "property" has at least two meanings within the law of Commonwealth countries including New Zealand. It may signify the title to all rights of ownership in goods or other property; for example, when s 20 of the Sale of Goods Act 1908 provides by r 1 that in a contract for the sale of ascertained goods in a deliverable state the "property" in the goods passes at the time the contract is made, "property" means the title to or ownership of the goods in question. The second, more general use, signifies

> the thing owned, that over which title is exercised. For example, when it is said that a person's property includes cars, books, royalty rights, and other property it is normally the second sense of the word "property" that is intended. In the first sense a person has property in a particular item; in the second sense, it is said that a person owns certain items of property. The context generally indicates which form is used.

From this, it can be seen that the term "property" is used to describe a wide range of things, both tangible and intangible. Its fundamental characteristics seem to be that it is capable of being owned and that the rights of ownership are capable of being transferred (see, for instance, the House of Lords decision in *National Provincial Bank Ltd v Ainsworth* [1965] 2 All ER 472). "Property" needs to be able to be defined and identified, and have a degree of permanence or stability. Further, it needs to able to be transferred.

"Real" and "personal" property

It is a well-established principle of English law that all "property" can be categorised as real property or personal property. As Garrow and Fenton in *Law of Personal Property* (6th ed, Butterworths, Wellington, 1998, page 1) explain:

> The distinction between real property (or realty) and personal property (personalty) is procedural in origin and is derived from the ancient forms of action in English law. In the twelfth century, the possession of freehold land and hereditaments was recoverable by certain actions called "real" actions; by "mixed" actions if both land and damages were claimed and "personal" actions if only damages were claimed. Remedies for interference with goods were seen to be in personam, giving rise to damages, rather than in rem.

The existence of only two classes of property has its origin in these two types of action. The acknowledgement that property is either real or personal is contained in the first sentence of the following quotation from Garrow and Fenton (at page 3):

> The distinction between land and personalty requires further qualification. Real property includes, besides estates and interests in land, things which are said to "savour of the realty".

The effect of there being only two classes of property, one being real and the other personal, is that a finding that something is property necessarily means that it will be either real or personal property. There is no third category. Therefore, in terms of the definition of "goods", if the item is "property", then it will be either real or personal property.

A question arises as to to the necessity of determining whether fishing quota are real or personal property. The section includes both types of property and as long as property is one or the other a final determination should not be needed. While this is true, attempting to classify the property as either real or personal helps to determine whether the item is a chose in action. The reason for this is that the distinction between chose in action and chose in possession appears to be limited to personal property.

Exclusion for "choses in action"

The term "chose in action" is used to describe various types of personal property. It is not a term that is applied to real property. This observation was made in the English case *Torkington v Magee* [1900–3] All ER 991 where Channell J defined the term (at page 994):

> Chose in action is a known legal expression used to describe all ***personal*** rights of property which can only be claimed or enforced by action, and not by taking physical possession.
>
> [Emphasis added]

Therefore, a finding that an item is real property means that the exclusion for choses in action will not be relevant. However, a finding that the item is personal property means that the exclusion for choses in action could be relevant. In determining the characteristics of a chose in action, several commentators refer to the above quotation from *Torkington v Magee* as providing a useful working definition.

In a New Zealand context, the Court of Appeal considered the issue in *Re Marshall (Deceased), CIR v Public Trustee* [1965] NZLR 851. This case considered a situation involving a right to demand interest on a loan, and whether this was a chose in action for the purposes of the Death Duties Act 1921. In considering the issue of a "chose in action", McCarthy J stated (at page 860):

> The right was property, for property in its wider sense includes all things of value. It was personal property and "all personal things are either in possession or in action. The law knows no *tertium quid* between the two". This celebrated statement of Fry LJ in *Colonial Bank v Whinney* (1885) 30 Ch D 261 at p 285, is familiar to every lawyer. It received, I think the express, but certainly the implied approval of the House of Lords on appeal ((1886) 11 AC 426).

McCarthy J provides further guidance on the characteristics of choses in action (at page 861):

> That is so because if the right to give the notice and the corresponding duty to accept it had been denied, there was no possible method of enforcement other than going to law and thereby **securing not the physical possession of the thing but the advantages of its ownership**. This, says Mr Cyprian Williams in his article in (1895) 11 LQR 223, is the true test, and I agree.
>
> …
>
> The characteristics that **one cannot take the right into physical possession** (even after judgment in one's favour)

> and that it **can only be vindicated by Court action**, are the qualifying features of a chose in action and have become the bases of most modern definitions.
>
> [Emphasis added]

The fundamental characteristic of a chose in action is the same in both authorities. Both authorities refer to the fact that in respect of a chose in action, one cannot take the right into physical possession. Being able to take the thing into possession is a characteristic of a chose in possession. Even if court action is taken to enforce the chose in action, the result may well be that the advantages of ownership are secured rather than actual physical possession of the thing.

"Secondhand"

There have been few cases on the meaning of the term "secondhand goods" in the GST context. In *Case N16* (1991) 13 NZTC 3,142 District Court Judge Barber had to consider whether deer velvet purchased direct from producers by means of commission agents was a secondhand good when it was purchased by a distributor and exporter of deer velvet.

Judge Barber concluded that the deer velvet was not a secondhand good. Judge Barber accepted that the two key concepts underlying whether something is secondhand are previous ownership and previous use. He stated at page 3,148:

> I agree with counsel that the concept of secondhand relates to pre-ownership or pre-use. I agree … that the emphasis is on pre-use. I consider that there is quite some commonsense flexibility in ascertaining whether a good is still new or has become secondhand. I do not regard second ownership as necessarily rendering an item secondhand. Many goods pass from manufacturer to wholesaler or retailer to customer or consumer (with other levels of distributors sometimes also involved), and yet are not regarded as secondhand at the consumer purchaser level, even though the item has been used as stock-in-trade at the various distribution levels. The good is not usually regarded as secondhand until it has been used for its intrinsic purpose.

The Taxation Review Authority felt that previous ownership of goods is not in itself necessarily sufficient to meet the test of secondhand in the Goods and Services Tax Act 1985. Usually a previous owner must have also used the goods for their intrinsic purpose.

Subsequently the Court of Appeal considered the meaning of secondhand in *LR McLean & Co Ltd v CIR* (1994) 16 NZTC 11,211. McKay J expressly referred to and agreed with Judge Barber's comments in *Case N16* as to the ordinary meaning of the term "secondhand". Justice Richardson (as he then was) stated (at page 11,213):

> The short point of the appeal is whether wool purchased by registered persons from unregistered persons is secondhand goods for the purposes of the 1985 Act. If the expression secondhand goods is given its ordinary and natural meaning it is common ground that it is not within that description. In ordinary usage the expression refers to goods which have been used, although depending on the context it may apply to goods which are no longer new or even in some contexts goods which have simply been previously owned. Mr Harley for the appellants did not seek to draw any distinction based on "use" of the wool by the sellers. The argument for the appellants is that to accord with the scheme and purpose of the legislation the expression has to be given the meaning of any goods which have been purchased by a registered person.

The judgments of the Court of Appeal state that the term "secondhand" should be given its ordinary or normal meaning. While "secondhand" can mean pre-owned or pre-used, the court concluded that it is not sufficient that the goods were previously owned. If an item were "secondhand" simply through being previously owned, the term "secondhand" would be deprived of any practical meaning according to Richardson J. Therefore, the Court of Appeal concluded that the more relevant factor is whether the goods have been previously used.

The effect of this is that the courts have not extended the meaning of the term "secondhand goods" to goods that have been previously owned but not previously used for their intrinsic purpose.

Application to fishing quota

Is fishing quota "property"?

When these concepts are applied to fishing quota, it seems that both individual transferable quota and annual catch entitlements constitute property. They are definable and identifiable through being granted under a statutory regime. Both are capable of being owned and specific legislative provisions in the Fisheries Act 1996 deal with the ability of individual transferable quota and annual catch entitlements to be transferred. On this basis, it can be accepted that a fishing quota is "property".

Is fishing quota real or personal property?

The next issue is whether individual transferable quota and annual catch entitlements are real or personal property. Their characteristics are determined by considering the legislation under which they are created. Under section 66 of the Fisheries Act 1996 (previously section 28O of the Fisheries Act 1983) the holders of individual transferable quota obtain a right to receive an annual catch entitlement for the species that is the subject of the quota. While the annual catch entitlement is defined by reference to a "quota management area", nothing in either of the Fisheries Acts suggests that it was intended that individual transferable quota or annual catch entitlements gives rise to an interest in land. Therefore, based on this and the earlier conclusion that neither individual transferable quota nor annual catch entitlements are profits à prendre, it is considered that they are neither an interest in land nor real property.

As individual transferable quota and annual catch entitlements are "property" and property is either "real" or "personal", the conclusion that individual transferable quota and annual catch entitlements are not real property leads also to the conclusion that they must be personal property. As individual transferable quota and annual catch entitlements are personal property, they will fall within the words "all kinds of real and personal property" in the definition of "goods" in the Goods and Services Tax Act 1985. Therefore, it is considered that this first part of the definition is satisfied. The next question is whether either of the two exclusions to the definition applies.

Is fishing quota a "chose in action"?

On the issue of whether individual transferable quota and annual catch entitlements are choses in action, it is established by the cases that the fundamental characteristic of a chose in action is that one cannot take the right into physical possession.

Both individual transferable quota and annual catch entitlements appear to possess this characteristic. The right to catch fish directly or indirectly cannot be taken into possession. While an argument could be made that a person could simply catch the fish under the quota, this seems to confuse the fish (which could be taken into possession) with the right to catch those fish (which, it is considered, cannot be taken into possession).

The result is that it is concluded that both individual transferable quota and annual catch entitlements are choses in action. While they are capable of satisfying the first part of the definition of "goods", being a form of personal property, they are then excluded from the definition of "goods" by reason that they are choses in action. The effect of this is that neither can be regarded as being "goods" for the purposes of the Goods and Services Tax Act 1985.

Given that it is concluded that individual transferable quota and annual catch entitlements are not "goods" in terms of the definition in the Goods and Services Tax Act 1985, there is no need to consider the further issue of whether they could be regarded as "secondhand". Because it is concluded that individual transferable quota and annual catch entitlements are not "goods", it is also concluded that they cannot be "secondhand goods".

Application to coastal permits and certificates of compliance

The consequences of section 122 of the Resource Management Act 1991 need to be applied to the definition of "goods" in the Goods and Services Tax Act 1985. The term "goods" means "all kinds of personal or real property". It has been established that, under section 122, coastal permits and certificates of compliance are deemed not to be "personal or real property". It has also been established that the deeming provision operates for purposes outside the Resource Management Act and so affects the Goods and Services Tax Act. As there is no legislative modification of the statement in respect of the Goods and Services Tax Act, coastal permits and certificates of compliance do not constitute "goods" for the purposes of the Goods and Services Tax Act as they are not personal or real property. Therefore, the further issue of whether they are "secondhand goods" does not need to be considered.

PUBLIC RULING BR PUB 09/06: LEASE SURRENDER PAYMENTS RECEIVED BY A LANDLORD—INCOME TAX TREATMENT

Note (not part of the ruling): This ruling is essentially the same as Public Ruling BR Pub 00/12 which was published in *Tax Information Bulletin* Vol 13, No 1 (January 2001). BR Pub 00/12 was a reissue of BR Pub 97/1 and BR Pub 97/1A which were published in *Tax Information Bulletin* Vol 9, No 1 (January 1997). The Ruling has been amended to take into account the Income Tax Act 2007 and to clarify the Commissioner's position as taken in BR Pub 00/12. BR Pub 00/12 expired on 31 March 2005. BR Pub 09/06 will apply for an indefinite period beginning on the first day of the 2008/09 income year.

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

Taxation Laws

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

This Ruling applies in respect of sections CB 1, CC 1(1) and CC 1(2).

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a lease surrender payment by a landlord from a tenant when the landlord, who is in the business of leasing property, agrees to accept the early termination of the lease. For the purposes of this Ruling, and for the avoidance of doubt, the term "business of leasing" has the same meaning as the term "business of renting", and means the business of letting property for a rent. The business of leasing property need not be the sole activity or the principal activity of the person. However, the activity must be sufficient, of itself, to amount to a business.

This Ruling applies only in respect of landlords in the business of leasing.

How the Taxation Laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- A lease surrender payment received by a landlord in the business of leasing property is income under section CB 1(1) as an amount derived from a business, unless the surrender of the lease is of such significance to the business that it constitutes the loss of a structural asset and the payment is thereby a capital amount. This will be a question of fact and degree to be determined in the particular circumstances of each case.
- A lease surrender payment is not income under sections CC 1(1) and CC 1(2) where the payment is not provided for in the terms of the lease.

The period for which this Ruling applies

This Ruling will apply to payments received by a landlord in the business of leasing for an indefinite period beginning on the first day of the 2008/09 income year.

This Ruling is signed by me on 30 June 2009.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 09/06

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 09/06 ("the Ruling").

Background

The subject matter covered in the Ruling was previously dealt with in Public Rulings BR Pub 97/1, BR Pub 97/1A (*Tax Information Bulletin* Vol 9, No 1 (January 1997)) and BR Pub 00/12 (*Tax Information Bulletin* Vol 13, No 1 (January 2001)). The Ruling has been amended to take into account the Income Tax Act 2007 and to clarify the Commissioner's position as taken in BR Pub 00/12.

The Ruling sets out the tax treatment of lease surrender payments received by a landlord who is in the business of leasing. The Ruling does not apply if the landlord is not in the business of leasing. However, it is to be noted that a lease surrender payment received by a landlord who is not in the business of leasing could still be considered to be income of that landlord.

Legislation

Section CB 1 provides:

> (1) An amount that a person derives from a business is income of the person.
>
> (2) Subsection (1) does not apply to an amount that is of a capital nature.

Subsections (1) and (2) of section CC 1 include within a person's income:

(1) An amount described in subsection (2) is income of the owner of land if they derive the amount from—

(a) a lease, licence, or easement affecting the land; or

(b) the grant of a right to take the profits of the land.

(2) The amounts are—

(a) rent:

(b) a fine:

(c) a premium:

(d) a payment for the goodwill of a business:

(e) a payment for the benefit of a statutory licence:

(f) a payment for the benefit of a statutory privilege; or

(g) other revenues.

Application of the Legislation

Section CB 1(1)

From a business

Under section CB 1(1), the income of a person includes an amount derived from a business. In the Court of Appeal decision in *CIR v City Motor Service Ltd; CIR v Napier Motors Ltd* [1969] NZLR 1,010, Turner J considered what was meant by the words "from any business" in a predecessor provision. His Honour stated (at pages 1,017–18):

> I think perhaps I do no more than reach his conclusion using other words when I say that in my opinion in the words "from the business" of the company something more is meant than merely "as a result of the fact that the company was carrying on this business". I think that *from the business* must mean *from the current operations of the business.* The distinction between capital accretions and revenue operations runs all through the law of income tax.
>
> ... and remembering that "Income Tax is always a tax on Income" I conclude without difficulty that the words "from any business" in an Income Tax Act must mean "from the current operations of any business" and no more. They are not, in my opinion, apt to include accretions to the capital assets of the taxpayer which, although they may result from the fact of this carrying on business, yet do not arise from the actual current operations of that business.

His Honour went on to consider the decision of the majority of the High Court of Australia in *Dickenson v FCT* (1958) 98 CLR 460, and then concluded (at page 1,019):

> But income tax being "always a tax on income", the crucial question in New Zealand must therefore in result be the same as that in Australia. Is the receipt income or capital? If it is gains or profits from a business, then the question reduces itself to whether these were derived from the *current* operations of the business, and therefore income, or whether no more can be contended, as regards their connection with the business, than that without the existence of the business they would not have accrued. If no more than this last can be proved, the gains cannot be assessable income, and simply because they are not derived from the current operations of the business.

Thus, if a receipt is an amount from a business, it is necessary only to consider whether or not that amount was derived from the current operations of the business in order to determine whether it is within the words "from a business" in section CB 1(1) ie, a revenue amount rather than a capital amount. Richardson J summarised it succinctly when delivering the Court of Appeal judgment in *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 as follows (at page 11,391):

> Whether gains produced in a business are revenue or capital depends on the nature of the business and the relationship of the transactions producing the gain to the conduct of the business ... A transaction may be part of the ordinary business of the taxpayer or, short of that, an ordinary incident of the business activity of the taxpayer although not its main activity. A gain made in the ordinary course of carrying on the business is thus stamped with an income character.

Sometimes the amount will not arise from the ordinary course of carrying on a business. The classic statement covering such situations is that of the Lord Justice Clerk in *Californian Copper Syndicate Ltd (Limited and Reduced) v Harris* (Surveyor of Taxes) (1904) 5 TC 159 (at pages 165–66):

> It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business.
>
> ...
>
> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being – Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business carrying out a scheme for profit-making?

This point was further considered by the New Zealand Court of Appeal in *Wattie & Anor v CIR* (1997) 18 NZTC 13,297, when rejecting the argument that the High Court of Australia decision in *FCT v The Myer Emporium Ltd* (1987) 87 ATC 4,363 had extended the categories of profit or gain that are treated as revenue amounts.

The Court of Appeal considered the following extract from *Myer*:

> Although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the ordinary course of carrying on the taxpayer's business is not income. Because a business is carried on with a view to a profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain may well constitute income. Whether it does depends very much on the circumstances of the case. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. Nor does the fact that a profit or gain is made as the result of an isolated venture or a "one-off" transaction preclude it from being properly characterized as income … The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit.

The Court of Appeal in *Wattie* then continued:

> Immediately afterwards the Court referred to the decision in *Californian Copper Syndicate Ltd v Harris (Surveyor of Taxes)*, (1904) 5 TC 159 as making the point. But that is simply the classic example of the well recognised assessability of a profit derived from an adventure in the nature of trade or, as it is put in a passage then quoted from *Californian Copper*, "a gain made in an operation of business in carrying out a scheme for profit making". At p211 the High Court observed that the important proposition to be derived from *Californian Copper Syndicate*:
>
> "… is that a receipt may constitute income, if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of the carrying on of the taxpayer's business, so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction."
>
> That seems to be a description of an adventure in the nature of trade, a description well able to be applied to what occurred in *Myer* itself. A gain from an adventure deliberately entered into with a view to the profit, though perhaps unprecedented for the taxpayer, will constitute income. It is a profit-making scheme. The profit is income in accordance with ordinary concepts.

Although the decision in *Wattie* was appealed to the Privy Council ((1998) 18 NZTC 1,991), counsel accepted the Court of Appeal's interpretation of *Myer* as "contemplating a profit arising from what is commonly referred to as an adventure in the nature of trade, of the kind illustrated by the decision in *Californian Copper*".

In circumstances where profits or gains are made outside the ordinary course of a taxpayer's business, it is necessary to consider whether such a profit or gain is of a revenue or capital nature. If the gain is made by way of the mere realisation of a capital asset, it will be a capital amount. However, if the gain is made by way of what has become known as "an adventure in the nature of trade", the gain will be a revenue amount.

In summary, therefore, the following statements can be made:

- An amount arising in the ordinary course of a taxpayer's business will automatically be treated as having a profit-making purpose and will thus be a revenue amount.
- Similarly, an amount arising as an ordinary incident of a taxpayer's business activity will be a revenue amount.
- An amount arising outside the ordinary course of a taxpayer's business will be a revenue amount if it arises from a business operation or commercial transaction with a profit-making purpose, e.g. an adventure in the nature of trade.
- An amount arising outside the ordinary course of a taxpayer's business will be a capital amount if it arises from the mere realisation of a capital asset, or if the amount is received in circumstances in which it is not possible to find a measurable profit or gain.

The critical question in the present case, therefore, is whether the receipt of a lease surrender payment by a landlord in the business of leasing is a receipt arising in the ordinary course of the landlord's business or as an ordinary incident of that business activity.

Ordinary incident of the business activity of leasing

In the Commissioner's opinion, the receipt of a lease surrender payment by a landlord is an ordinary incident of the business activity of leasing. The only exception to this is if the surrender payment is received in respect of a lease which is of such significance to the business that it constitutes a structural asset. This will be a question of fact in the particular circumstances of each case.

No New Zealand authorities on the taxation of a lease surrender payment received by a landlord exist, and there are very few overseas authorities on this issue. The New Zealand Court of Appeal did consider a lease surrender payment in *CIR v McKenzies New Zealand Ltd* (1988) 10 NZTC 5,233. However, this decision concerned the deductibility for a lessee of a lease surrender payment paid to a lessor. While the decision is considered to be good authority in relation to the deductibility of a lease surrender payment for a lessee, the comments made by the Court in that context cannot automatically be applied to the question of the assessability of such a payment to a lessor (ie, symmetrical tax treatment is not required in terms of different parties to the same transaction). The character of a payment for assessability and deductibility purposes has to be tested in the hands of the particular taxpayer. Similarly, the Privy Council decision in *Wattie* considered the character of leases from the point of view of the lessee. It is considered that the nature of a lease in a lessor's business is different to that of a lessee.

In most cases, a lessee will use the property as accommodation for carrying out its income earning process. The lease will not directly form part of the taxpayer's profit making activities. The lease will also provide the lessee with an interest in the land which could be considered to be an enduring benefit. However, as far as a taxpayer in the business of leasing is concerned, the lease or leases will generally be part of the income earning process rather than the capital structure. On the surrender of the lease, the lessee no longer has an interest in the land or premises and no longer has a capital asset. The lessor, in contrast, retains possession of the underlying land or premises.

A Canadian decision that is potentially relevant is the decision in *Monart Corporation v Minister of National Revenue* [1967] CTC 263. The taxpayer in that case owned a large office building. One of its tenants, occupying one-tenth of the leased floor area of the building, gave notice that it was going to vacate and the taxpayer accepted $75,000 to cancel the lease for the remaining six years of its term. The Court concluded that the sum of $75,000 paid to the taxpayer was in lieu of future rent and was also in the nature of profit derived from a property or business of the taxpayer. It was therefore assessable to the taxpayer.

Although Canadian and New Zealand law differs on the characterisation of a lease asset (and the Privy Council in *Wattie* expressed some doubt as to whether Canadian law in this area could be applied in New Zealand), for present purposes it is relevant to note that Dumoulin J in *Monart Corporation* stated that the taxpayer corporation's, "raison d'être, and sole pursuit, consist in the business of renting office accommodation". His Honour then went on to expressly accept the submission of counsel for the respondent that (at page 271):

> … the amount received by the Appellant was paid to it for damages suffered or to be suffered as the result of the premature termination of the lease, and that the termination can be considered as a normal incident in the activities of a landlord renting properties.

Some guidance on the question of whether a lease surrender payment is a capital or revenue receipt may be gained from considering cases concerning compensation for termination of agency contracts. An analogy can be drawn between receiving a lease surrender payment (compensation for terminating a lease) and receiving compensation for termination of an agency contract.

In *Kelsall Parsons & Co v Commissioners of Inland Revenue* (1938) 21 TC 608, the taxpayers carried on business as commission agents for the sale in Scotland of the products of various manufacturers, and entered agency agreements for that purpose. One particular agency was cancelled and the taxpayers were paid £1,500 in compensation. The taxpayers claimed it was a capital amount, whereas the Commissioners claimed it was a revenue amount. The Court upheld the Commissioners' view.

The Lord President, Lord Normand, stated (at pages 619–20):

> The sum which the Appellants received was, as the Commissioners have found, paid as compensation for the cancellation of the agency contract. That was a contract incidental to the normal course of the Appellants' business. Their business, indeed, was to obtain as many contracts of this kind as they could, and their profits were gained by rendering services in fulfilment of such contracts.
>
> …
>
> It was a normal incident of a business such as that of the Appellants that the contracts might be modified, altered or discharged from time to time, and it was quite normal that the business carried on by the Appellants should be adjustable to variations in the number and importance of the agencies held by them, and to modifications of the agency agreements, including modifications of their duration, which might be made from time to time. … In parting with the benefit of the contract, moreover, the Appellants were not parting with something which could be described as an enduring asset of the business. The contract would have been terminated in any event as at the 30th September, 1935.

In *Commissioners of Inland Revenue v Fleming & Co (Machinery) Ltd* (1951) 33 TC 57, the taxpayer company carried on the business of agents and merchants for the sale of machinery and explosives; the agency work greatly predominating. In 1948 one of its agencies was cancelled and the company received a sum in compensation. The Court of Session (First Division) held that the sum was a revenue receipt.

The Lord President, Lord Cooper, noted (at page 61) that the issue belonged to a type exemplified by a number of earlier cases in which, broadly speaking, the line had been drawn between:

> ... (a) the cancellation of a contract which affects the profit-making structure of the recipient of compensation and involves the loss by him of an enduring trading asset; and (b) the cancellation of a contract which does not affect the recipient's trading structure nor deprive him of any enduring trading asset, but leaves him free to devote his energies and organisation released by the cancellation of the contract to replacing the contract which has been lost by other like contracts.

Lord Russell explained this distinction further (at page 63):

> When the rights and advantages surrendered on cancellation are such as to destroy or materially to cripple the whole structure of the recipient's profit-making apparatus, involving the serious dislocation of the normal commercial organisation, and resulting perhaps in the cutting down of the staff previously required, the recipient of the compensation may properly affirm that the compensation represents the price paid for the loss or sterilisation of a capital asset and is therefore a capital and not a revenue receipt ... On the other hand when the benefit surrendered on cancellation does not represent the loss of an enduring asset in circumstances such as those above mentioned – where for example the structure of the recipient's business is so fashioned as to absorb the shock as one of the normal incidents to be looked for and where it appears that the compensation received is no more than a <u>surrogatum</u> for the future profits surrendered – the compensation received is in use to be treated as a revenue receipt and not a capital receipt.

It was held that the company's main business consisted of acquiring agencies, and the diminution or increase in the number of agencies (whether prior to the due date of expiration or not) could be regarded as a normal incident of its business. The structure of the company's business was not affected. The sum received had to be regarded as compensation for loss of profits and not for loss of a profit earning asset.

In *Wiseburgh v Domville (Inspector of Taxes)* [1956] 1 All ER 754 (CA), the taxpayer was a manufacturers' agent. One agency was determined by the principals without the required notice, and the taxpayer suffered a serious reduction in his earnings. The taxpayer brought an action for damages for breach of the contract and for commission due up to the breach. The action was settled and the taxpayer received £4,000, expressed to be damages for the breach of agreement and costs; the claim for commission having been abandoned.

Lord Evershed MR noted that at the time the agency was terminated the taxpayer held only two agencies, although he had held a varying number of agencies during his time as an agent. It was also noted that, "the effect of the loss of this contract, quoad the taxpayer's agency business, was very substantially to depreciate his earnings". Nevertheless, his Lordship stated (at pages 758–59):

> Here, the taxpayer has been carrying on a business which for thirteen years has shown variations in the actual agreements which it has comprehended. The business has suffered something perhaps of a disaster by reason of this quarrel with a valuable customer. But, beyond that, it seems to me it is not right to say that the taxpayer had his undertaking as a sales agent partially destroyed or taken away.
>
> ...
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> Harman J. said ([1955] 3 All ER at p.551):
>
>> "The taxpayer was a manufacturers' agent. He had other agencies from time to time and carried on business as an agent, and one of the incidents of such businesses is that one agency may be stopped and another begun. The fact that an agency was a key agency, and was therefore important to him and represented half of his income, seems to me to be irrelevant."
>
> With the possible exception of substituting "inconclusive" for "irrelevant", I agree entirely with that statement; and I agree with what the judge said later (ibid.):
>
>> "... it was a normal incident in this kind of business that an agency should come to an end, and it seems to me that the compensation paid is quite clearly income."

Van den Berghs Ltd v Clark (Inspector of Taxes) [1935] All ER 874 concerned payments made under agreements entered between competitor companies (both margarine manufacturers) for the sharing of profits and losses and the regulation of their activities. Following a dispute under the agreements, the taxpayer received a payment of £450,000 as "damages" and in consideration of the termination of the agreements. The House of Lords held that the payment was a capital receipt. Lord MacMillan discussed *Atherton v The British Insulated & Helsby Cables Ltd* [1926] AC 213 and then proceeded to consider the facts before him. He considered that it was important to bear in mind that the taxpayer's trade was to manufacture and deal in margarine. The payment received was in consideration for the taxpayer giving up its rights under the agreements for the following 13 years. Lord MacMillan said (at page 888) that these agreements:

> ... were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits, when earned, should be distributed as between the contracting parties. On the contrary, the cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what

> they might not do, and affected the whole conduct of their business. I have difficulty in seeing how money laid out to secure, or money received for the cancellation of, so fundamental an organisation of a trader's activities can be regarded as an income disbursement or an income receipt … In the present case, however, it is not the largeness of the sum that is important but the nature of the asset that was surrendered. In my opinion that asset, the congeries of rights which the appellants enjoyed under the agreements and which, for a price they surrendered, was a capital asset.

In *Barr, Crombie & Co Ltd v CIR* (1945) 26 TC 406, from the formation of a shipping company in 1924, the appellant company managed its ships under certain agreements, the latest of which provided that the appellant company should continue to act as managers for the shipping company for 15 years from 1 January 1936. A clause in the contract provided that if the shipping company went into liquidation or ceased to trade, then the remuneration owing to the appellant from that day until the date on which it was due to expire would become immediately payable to the appellant. In 1942 this occurred and the appellant received the amount due.

The Lord President, Lord Normand, found that the appellant's business had consisted almost entirely of the agency. For the previous 16 years it had contributed about 84 percent of the appellant's income. Upon liquidation of the other company, it lost almost its entire business. Despite the fact that the sum payable was calculated by reference to what the appellant would have received had the company not gone into liquidation, the Lord President found that the sum received was a capital amount. He quoted Lord Buckmaster in *Glenboig Union Fireclay Co Ltd v CIR* (1922) 12 TC 427 where he said (at page 464):

> … although annual payments in the nature of profits may be used as the measure by which to calculate the sum which is to be paid, the resultant sum is not thereby made itself an annual payment or a profit.

His Lordship distinguished *Kelsall Parsons & Co*. He regarded the payment before him as being "once and for all" ie, the price of the surrender of its only important capital asset. In contrast, in *Kelsall*, the payment was in return for the loss of a single agency contract out of about a dozen, and the fact that the payment in that case did not represent the whole capital asset of the company was shown by the fact that the next year its profits were no less than they had been before. Another contrasting feature was that in that case there was a single payment for the surrender of profits over one year, as opposed to a payment for the surrender of an agreement while there was still a substantial period to run. Lord President Normand considered the case analogous to *Van den Berghs* in that the structure of the company was radically affected and its whole character as a business decisively altered. He said:

> … where you have a payment for the loss of the contract upon which the whole trade of the Company has been built, where the expected profits of the contract are used to measure the loss of them for a period of future years, and where in consequence of the loss the Company's structure and character are greatly affected, the payment seems to me to be beyond doubt a capital payment.

The leading case in New Zealand, regarding the characterisation of a payment received for cancellation of a contract, is the Court of Appeal judgment of *CIR v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 14 NZTC 9,101. That case involved the receipt by the taxpayer of $2.25m as consideration for the variation and partial surrender of its rights under a long-term supply contract. The issue was how to characterise the receipt in the hands of the recipient.

The Court of Appeal stated that the crucial consideration in the case was whether, on the facts, the 1972 supply and marketing contract was to be characterised as providing an advantage for the enduring benefit of Borthwick's trade and as forming part of the structure of Borthwick's marketing operations.

The Court of Appeal rejected the Commissioner's argument that in deciding this issue Gallen J had placed too much emphasis on the duration of the marketing rights and too little on its limited impact on the taxpayer's business as a whole. In applying what it described as being the leading case in which a contract was held to be a structural asset, *Van den Berghs Ltd v Clark* [1935] AC 431, the Court of Appeal stated that "whether a supply and agency contract is structural or revenue turns on the nature and significance of the contract in the operations of the business" (at page 9,105). The Court confirmed that duration, arguably over business share, is significant. Applying the observations of Lord Pearce in *BP Australia Ltd v C of T* [1966] AC 224, the longer the duration, the greater the indication that a structural solution is being sought. The Court, deciding the sum was capital, found on the facts that:

- the marketing agreement assured the taxpayer of a long-term source of supply of produce for its marketing business;
- the supply of produce replaced the previously held capital asset, ie, the freezing works, and in that way the agreement was then the framework for making profits from the South Island;
- globally the agreement was of major significance to the taxpayer's business, ie, 40 percent increase in share of New Zealand lamb kill;

- the size of the payment indicated the agreement's value and importance to the business.

An analogy can be drawn between the receipt of compensation for the termination of a contract, and the receipt of a lease surrender payment on the termination of a lease.

Whether a lease is always a capital asset

Some commentators have suggested that *McKenzies* is authority for the proposition that a lease will always be a capital asset to both a lessor and a lessee (unless the taxpayer is in the business of buying and selling leases). Certain quotes in the judgment could be seen to support this view – most notably Richardson J's comment that "[h]ere, as in the case of most taxpayers, the lease was part of the profit making structure of the business". However, it is not clear from the judgment whether Richardson J was intending to include lessors within this, or whether he was referring to lessees whose leases would (unless the lessee was in the business of acquiring leases to sell) generally be capital assets.

To the extent that Richardson J was suggesting that the quote applied more widely to lessors as well, such comments are obiter dicta, not being relevant to deciding the issue in dispute (which involved McKenzies as a lessee making a lease surrender payment). Further, if the case is suggesting that a lease will always be some kind of capital "asset" for a lessor, in whatever circumstances, it is the Commissioner's view that this interpretation of the judgment overstates the situation for the reasons set out above.

Summary

In general, it is a normal incident of the business of leasing that leases might be modified, altered, or surrendered from time to time and it is quite normal that such a business should be able to take into account such modifications, alterations, or surrenders.

However, in certain circumstances the surrender of a lease may constitute the loss of an enduring asset of the business and the receipt of a lease surrender payment by the landlord may be a capital amount. The more fundamental to the landlord's business a particular lease is, the more likely the payment will relate to the giving up of an enduring asset in the form of part of the business structure and will be considered capital in nature. This will be a question of fact in any particular case. The cases discussed above indicate that the following principles will apply:

- It is necessary to ascertain whether the cancelled lease is of such a nature and significance to the landlord's business so as to form part of the profit-making structure. If this is the case, then the related payment will be capital. However, where the cancelled lease does not form part of the profit-making structure or deprive the landlord of an enduring asset, then the cancellation of such a lease returns the underlying capital asset to the taxpayer to use to earn income. In such circumstances the lease surrender payment received will be revenue in nature.
- In determining the nature and significance of the lease in relation to the landlord's activity, regard may be had to the duration of the agreement and also to whether the landlord ordinarily enters into such agreements. In this respect, the more fundamental the agreement is to the landlord's business (ie, the more "crippled" the business is subsequent to the agreement's cancellation) the more likely it is to be capital.
- Where a lease is surrendered and the property concerned cannot readily be leased again (for example where the property has been set up for a particular purpose which is specific to the lessee), the lease surrender payment may be considered to be a capital amount.
- The method of calculation of the sum payable is not determinative (however, where a lease surrender payment is merely commutation of rent that would otherwise have been payable under the lease, this may point towards the payment being revenue in nature).
- If the lease constitutes the whole structure of the profit making apparatus, the receipt may be on capital account.
- If the landlord has several leases as part of its business structure and the receipt relates to only one of them, then generally the receipt will not relate to the capital structure. However, this may not be the position if the one lease out of several constitutes a significant part of the business.

It is to be noted, in this regard, that if the facts of a situation suggest that a taxpayer has structured its, or its group's, affairs in a particular way for the purpose or effect of converting a revenue receipt into a capital receipt, the Commissioner may consider the application of the anti-avoidance provisions of the Income Tax Act 2007.

Conclusion

The receipt of a lease surrender payment by a landlord in the business of leasing is a normal incident of that business. Such a receipt will therefore constitute income within section CB 1(1) as an amount derived from a business. The only exception to this is where the surrender payment is received in respect of a lease that is of such significance to the landlord's business that it constitutes a structural asset. This will be a question of fact in the particular circumstances of each case.

Although the Ruling deals only with the receipt of a lease surrender payment by a landlord in the business of leasing, it should be noted that the fact that a lease surrender payment is received by a landlord who is not in the business of leasing will not automatically exclude that payment from the landlord's income. It will still be necessary to consider whether the payment is to be included as a revenue amount on some other basis, such as on the basis that the amount arose from an adventure in the nature of trade. Equally, the receipt could be a normal incident of some other business activity of the recipient and thus a revenue receipt. If the lease surrender payment is simply a lump sum payment to reflect lost rent, it is likely that it would be a revenue receipt.

Example 1

Landlord A owns a number of commercial properties, and is in the business of leasing them. She leases one building to Tenant. Landlord A and Tenant execute a lease for 15 years at a rental of $50,000 per annum: the rental being reviewable every five years. The lease provides for one right of renewal for a further 15-year period.

Five years into the lease, Tenant's business outgrows Landlord A's building. Tenant moves the business to another property. Tenant offers to pay Landlord A $200,000 if she will accept a surrender of the lease by Tenant and the cancellation of all Tenant's obligations under the lease. Landlord A agrees, the lease is cancelled, and Tenant pays Landlord A the $200,000.

Under section CB 1(1), the amount is income of Landlord A.

Example 2

Landlord Z is a company and is the landlord of a commercial property that was purpose built for a particular tenant. The management of the leasing arrangements takes considerable time and effort and is carried out solely by Landlord Z, which has no other business activities. The lease was for 50 years and has 30 years still to run. The building is now in an unfashionable area and the tenant has to move to survive. There is no possibility of securing a further tenant. The tenant negotiates a lease surrender payment with Landlord Z.

Landlord Z is in the business of leasing and is therefore subject to the Ruling. However, the surrender payment is in respect of a significant asset of the Landlord's business and affects the profit-making structure of the business. The surrender payment received by Landlord Z will be a capital amount.

Subsections (1) and (2) of section CC 1

Section CC 1 potentially applies to a lease surrender payment. That section includes within the landowner's income, "other revenues" derived by a land owner "from a lease". The words "other revenues" are potentially wide enough to include a lease surrender payment. In the Commissioner's view, the words "from a lease" require that there is a nexus between the payment and the lease ie, that the payment can be said to arise or emanate from the lease or have the lease as its source.

The Commissioner considers that the amounts listed in section CC 1(2) are amounts paid for the use of land. A lease surrender payment is paid to terminate a person's use of land. It therefore does not come within any of the types of payment listed. As a lease surrender payment is paid to prematurely end the relationship between lessee and lessor, does not enhance or further that relationship, and cannot be said to flow from the lease, there is not a sufficient nexus between the payment and the lease. Therefore, a lease surrender payment is not an amount to which section CC 1 applies.

The conclusion that the section does not apply is also supported by *obiter dicta* of Richardson J in *CIR v McKenzies NZ Ltd* (1988) 10 NZTC 5,233, at 5,235, where His Honour said that premiums paid or received on the surrender of a lease were not dealt with in a predecessor section to section CC 1.

This Ruling only applies in the more common situation where the terms of the lease do not provide for a lease surrender payment. In the event that a lease provided for what is to occur upon the surrender of a lease, the specific terms would have to be considered to determine whether section CC 1 applies.

When a landlord's activity amounts to a business

The term "business" is defined in section YA 1 as including any profession, trade, or undertaking carried on for profit.

The leading case on the test and criteria for whether a business exists is *Grieve v CIR* (1984) 6 NZTC 61,682. In *Grieve*, Richardson J noted there were two factors in deciding if there was a business: first, whether the taxpayer had an intention to make a profit; second, the nature of the activities carried on. He went on to set out the following factors relevant to the inquiry as to whether a taxpayer is in business:

- the nature of the taxpayer's activities
- the period over which the taxpayer engages in the activity
- the scope of the taxpayer's operations

- the volume of transactions undertaken
- the commitment of time, money, and effort by the taxpayer
- the pattern of activity
- the financial results achieved by the activity.

Ultimately, whether a landlord is in business is a question of fact. In seeking to determine whether a landlord is in business, the Commissioner uses the criteria identified above from the *Grieve* decision. The question of whether a business existed or not also arose in *Slater v CIR* (1996) 17 NZTC 12,453. The High Court examined, discussed, and approved *Grieve* and the tests proposed in that case.

A taxpayer who is in doubt as to whether or not a leasing activity amounts to a business should contact a tax adviser or Inland Revenue.

Case law on whether a landlord's leasing activity amounts to a business

Several cases consider whether the leasing of property for rents amounts to a business.

In *LD Nathan Group Properties Ltd v CIR* (1980) 4 NZTC 61,602, the taxpayer was the property-owning subsidiary of the group. Davison CJ said that the deriving of rents by a company such as the taxpayer was income from a business. This confirms the approach in *Smith v Anderson* (1880) 15 Ch D 258, *CIT v Hanover Agencies Ltd* [1967] 1 All ER 954 (PC), and *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1978] 3 All ER 1185 (PC) that companies involved in leasing will more readily be held to be in the business of property leasing. However, this classification is not limited to company taxpayers. For example, in *Case F111* (1984) 6 NZTC 60,094 the taxpayer owned two houses and a block of five flats. She collected the rents, interviewed tenants and did some of the maintenance and repair work. The Taxation Review Authority was of the view that the taxpayer was in business as a landlord.

From these cases, it would appear that leasing several buildings is likely to mean a taxpayer is in the business of property leasing. Leasing only one building can also mean a taxpayer is in the business of property leasing, if the requirements of the building mean the landlord is actively and regularly involved with the property (eg, negotiating new leases, maintenance, and renovations). It is also possible that leasing a single building will not mean the landlord is in the business of property leasing (eg, when the landlord does not need to have much involvement with the day-to-day running of the property, or when new lessees, maintenance, or renovation work are rare). It is interesting to note that the cases suggest that the business threshold is lower when the landlord is a company than when the landlord is an individual or individuals.

Two Australian cases discussed below found the renting of property did not amount to a business. To the extent that these cases are inconsistent with the cases discussed above they are not considered to be precedential, and the above authorities, being Privy Council and New Zealand High Court and Taxation Review Authority cases, are more persuasive authorities in a New Zealand court.

In *Case 24* (1944) 11 TBRD 85, the taxpayer owned three properties returning rental income of over £10,000. The taxpayer employed a manager who collected and banked rents, attended to repairs and supervised them, and controlled the caretaker and cleaners. However, the taxpayer personally carried out the management of his rent-producing properties and directed policy; attending to the financial arrangements and making decisions regarding repairs. He employed an accountant to prepare accounts. The Board of Review (in a 2-1 decision) found that the taxpayer did not have a business of renting property. In light of subsequent case law, particularly *Case F111*, this decision is unlikely to be persuasive authority in New Zealand.

In *Kennedy Holdings & Property Management Pty Ltd v FCT* 92 ATC 4,918, the taxpayer co-owned a building that it rented out. It paid its lessee a sum of money to surrender the lease and sought to deduct the sum. The deduction was denied by the Commissioner, and the Federal Court (NSW) upheld the Commissioner's assessment. The Court found the taxpayer was not carrying on a business. Hill J said (at page 4,921):

> It cannot be said on the evidence of the present case that the applicant is, for purposes relevant to s.51(1), carrying on a business. The applicant and its co-owner own one property which they lease out and from which they derive rental income. The freehold held in co-ownership is, in such circumstances, the income producing entity, structure or organisation for the earning of the rental income of the co-owners. The freehold is the profit-making structure.

Again, there must be some doubt as to the persuasiveness of this case in New Zealand. However, it may be seen as an example of a company owning one building and not needing to undertake much effort in its management, and therefore not being in the business of renting property.

Another example of a company renting out property without carrying on a business is *R & C Commissioners v Salaried Persons Postal Loans Ltd v R & C Commissioners* [2006] BTR 423. In this case a company had carried on a trade from one set of premises which it owned. In 1966 the company moved its trade to other premises and let its own premises out. In 1995 the company stopped its trade. Since then the rent received for its original premises had been the sole source of income. The company had had no employees or a bank account and had not paid any money to directors or made any distributions. The tenant of the original premises had remained the same throughout the years.

The Court found that a company whose sole activity is the collection of a modest amount of rent under a longstanding lease is not carrying on a business.

Example 3

Landlord B is retired and owns two properties: a family home, and another house rented to an architect for use as an office. The rent is direct credited to Landlord B's bank account. Landlord B has no day-to-day involvement with the tenant or the building, and only very rarely needs to arrange for repairs and maintenance to be carried out. The tenant has tenanted the building for five years, and has a further five-year lease over the building. In terms of the *Grieve* tests, the scope of Landlord B's operations, the volume of transactions undertaken, the commitment of time, money, and effort by the taxpayer, the pattern of the activity, and so on, all suggest that her renting does not amount to a business.

Example 4

Landlord C is in part-time employment, but also owns six houses that he rents out to tenants. Before renting out a house, Landlord C totally renovates it. Thereafter, Landlord C carries out any repairs that may be required. He undertakes advertising for new tenants, collection of rents, and associated duties. Landlord C is in the business of renting on the strength of both *Case F111* and the *Grieve* test. Unlike Landlord B in example 3, the nature of Landlord C's activities, the scope of the operations, the volume of transactions undertaken, and the commitment of time, money, and effort all suggest a business exists.

Period of the Ruling

The Ruling commences on the first day of the 2008/09 income year. The previous ruling expired on 31 March 2005. Given the terms of section 91C of the Tax Administration Act 1994, it is not possible to issue a ruling in respect of the Income Tax Act 2004 for the period beginning 1 April 2005 to the end of the 2007/08 income year. However, the Commissioner is of the view that the same principles and conclusions as set out in this ruling apply to any lease surrender payments received by a landlord in the business of leasing during this period.

LEGISLATION AND DETERMINATIONS

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

DETERMINATION 09/03: AMOUNT OF HONORARIA PAID TO MEMBERS OF THE ROYAL NEW ZEALAND PLUNKET SOCIETY (INC) THAT SHALL BE REGARDED AS EXPENDITURE INCURRED IN PRODUCTION OF PAYMENT

This statement may be cited as "Determination 09/03: *Determination of expenditure incurred for honoraria payments made by the Royal New Zealand Plunket Society (Inc)*".

Introduction

All legislative references are to the Income Tax Act 2007 ("the Act").

This determination sets out the amount regarded as expenditure incurred in the production of schedular payments (formerly withholding payments) when those payments are honoraria paid to members of the Royal New Zealand Plunket Society (Inc) ("Plunket").

Section RA 5 of the Act requires anyone who makes an employment-related payment to deduct tax when making it.

Under section RD 3(1) of the Act a schedular payment is included in the definition of "PAYE income payment". Consequently, any person who makes a schedular payment must deduct tax from it at the time it is made, unless an exemption applies.

Honoraria paid to Plunket members come within the definition of "schedular payment" under section RD 8 of the Act. Schedule 4, Part B of the Act requires PAYE to be deducted from honoraria at the rate of 33%.

Section RD 8(3) of the Act allows the Commissioner to determine an amount or proportion of any schedular payment that is considered to be expenditure incurred in the production of that payment. If the Commissioner has made such a determination, the person making the schedular payment is only required to deduct tax from the amount that exceeds the determined expenditure amount.

Application

This determination applies to payments made to Plunket members as reimbursement of costs incurred in undertaking Plunket-related matters. It applies to honoraria paid on or after 1 April 2008.

This determination will apply until it is replaced or withdrawn.

Determination

When any Plunket member receives honoraria as reimbursement of expenditure that member had incurred in carrying out Plunket related activities that payment, up to a maximum of $700 per annum, shall be regarded as expenditure incurred in the production of that payment. However, if the member receives any reimbursement (in addition to honoraria) for expenditure they have incurred, the amount exempted under this determination ($700) shall be reduced by that additional reimbursement.

Example 1

A Plunket member receives honoraria of $500 in respect of the Plunket-related activities carried out during the year. No other reimbursement had been paid during the year. The payer does not have to deduct tax because the total payment does not exceed $700.

Example 2

A Plunket member receives a payment of $625 at the end of February. During the year in May and August the member had also received two smaller payments of $100 each as reimbursement of expenses incurred for Plunket-related activities, making a total of $825 for the year. Because the Plunket member had received reimbursement payments of $200 earlier in the year, only $500 of the honorarium received in February could be regarded as expenditure incurred under this determination. Therefore, tax of $41.25 should be deducted from the balance ($125) of the honorarium.

This determination is signed on the 30th day of June 2009.

Rob Wells

LTS Manager, Technical Standards

NEW LEGISLATION

DETERMINATION DEP 71: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 71

This determination may be cited as "Determination DEP 71: *Tax depreciation rates general determination number 71*".

1. Application

This determination applies to taxpayers who own items of depreciable property of the kind/s listed in the table below that have been acquired on or after 1 April 2008.

This determination applies for the 2008 and subsequent income years.

2. Determination

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

- Adding into the "*Timber & Joinery Industries*" industry category the general asset class for Firewood Processors and Log Splitters, estimated useful life 10 years, and diminishing value and straight-line depreciation rate of 20% and 13.5% respectively as listed below:

General asset class	Estimated useful life (years)	DV Rate (%)	SL Rate (%)
Firewood Processor (manually operated)	10	20	13.5
Firewood Processor (computerised)	10	20	13.5
Log Splitter (manually operated)	10	20	13.5
Log Splitter (computerised)	10	20	13.5

3. Interpretation

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

This determination is signed by me on the 24th day of June 2009.

Rob Wells

LTS Manager, Technical Standards

LEGAL DECISIONS – CASE NOTES

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

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

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.

TAXPAYER SHOULD PROCEED TO CHALLENGE PROCEEDINGS WHEN DISPUTING THE VALIDITY OF A NOTICE OF RESPONSE

Case	Commissioner of Inland Revenue v Alam and Begum
Decision date	26 June 2009
Act	Tax Administration Act 1994
Keywords	Notice of Response, assessments

Summary

Where an assessment has been issued after the Commissioner has declined to accept a taxpayer's NOR as valid, the taxpayer should proceed to challenge proceedings to dispute the validity of the Notice of Response.

Impact of decision

The Court of Appeal's decision is that once there is a valid assessment by the Commissioner, the next step for the taxpayer is to proceed to challenge proceedings. The issue of whether there is a valid Notice of Response ("NOR") should be considered at the challenge proceedings rather than at Judicial Review proceedings.

Facts

On 4 July 2001 the Commissioner issued a Notice of Proposed Assessment ("NOPA") under section 89F of the Tax Administration Act 1994 ("TAA") to the taxpayers, disallowing a GST claim for payment made to one Rafi Achmed ("Rafi"). The NOPA alleged there was no evidence that payment had been made to Rafi.

The taxpayers' NOR of 3 July 2001was "sparse" in so much as it contained the bare assertion that they did pay Rafi.

On 4 July 2001, the Commissioner rejected their NOR on the ground that it did not provide sufficient detail to constitute a valid NOR and subsequently issued assessments.

On 22 March 2007, the taxpayers applied for a judicial review of the Commissioner's decision to reject their NOR.

At the hearing in the High Court, Woodhouse J, held that the NOR was valid and the Commissioner had no power under the disputes process to reject it.

In the Court of Appeal ("the Court"), the Commissioner put his case on the basis that a valid assessment had been made [paragraphs 16 and 17] regardless of the taxpayers' contention about the rejection of their NOR.

The Court considered the following issues:

(1) What course should a taxpayer take when he or she considers that the Commissioner has wrongly rejected his/her NOR and applied the deemed acceptance provision in section 89H (1) of the Tax Administration Act 1994 ("TAA")?

(2) Was the High Court wrong to exercise its discretion to grant relief?

Decision

On the first issue the Court answered that the taxpayers should proceed by challenge proceedings under the TAA for the following reasons:

- The Commissioner had no power to reject the NOR and therefore the deemed provision under section 89H (1) did not apply.
- The taxpayers should therefore proceed to challenge the assessments under section138B of the TAA.
- The issue of the validity of the NOR could be raised at that point and could be raised in an application for a strike out by the Commissioner under section138H of the TAA.

On the second issue, the Court held that the judicial review application had no or little value to the taxpayers as the assessments remained valid and could be disputed through the disputes process. The High Court should not have granted the relief.

The Commissioner's appeal was allowed and the declaratory order of the High Court quashed.

COURT OF APPEAL SAYS OMISSION TO ACT CAN BE AIDING OR ABETTING

Case	Neil George Evans v Commissioner of Inland Revenue
Decision date	26 June 2009
Act	Tax Administration Act 1994
Keywords	Aiding or abetting, omission, employee, officer or agent

Summary

The taxpayer appealed against a High Court decision that a director of a company had aided or abetted the company to commit a tax offence (section 148 of the Tax Administration Act). The Court of Appeal upheld the High Court decision and confirmed that an omission by a director to do an act can mean that the director aided the company to offend.

Impact of decision

The decision confirms that the absence of the word "omission" from section 148 of the Tax Administration Act ("TAA") does not preclude the Commissioner from charging a director or any other with an offence when they have "omitted" to do an act required of them. The Commissioner can also charge an employee, officer or agent of a company under section 148 of the TAA even though section 147 is a specific section relating to employees, officers or agents of a company.

Facts

The Appellant was the sole director of a company which was charged with a number of offences under section 143A of the TAA. The charges related to using PAYE deductions for purposes other than payment to the Commissioner. The responsibility for paying the PAYE deductions to the Commissioner on behalf of the company lay with the Appellant. The Appellant was charged under section 148 of the TAA as a person who aided or abetted another to commit an offence against the Act.

In the District Court, the company was found guilty of the offences charged. The Appellant was found not guilty. The Judge held that the prosecution had not proved that the Appellant had actively assisted the company to commit the offences.

The Commissioner appealed to the High Court by way of case stated, the questions of law being posed by the Judge being:

- Was I wrong in concluding in the circumstances of this case that section 148 of the TAA 1994 requires the informant to prove that the defendant actively assisted the company in its offending?
- Was the only conclusion available to me that the sole director Neil George Evans was also guilty of the offences as a party?

In a decision dated 2 July 2008, Wylie J allowed the appeal. The appellant then appealed to the Court of Appeal.

The appellant's main grounds for appealing were that because he did not write out a cheque for the PAYE he had committed an "omission" and that an "omission" was not an act but rather a failure to act, therefore he could not aid or abet.

He argued that section 147 of the TAA 1994 (which relates to offences by employees, agents or officers of a body corporate) has specific reference to an offence if an "omission" occurs because of them.

He also argued that sections 66 of the Crimes Act 1961 is similar to section 148 of the TAA in that it relates to parties to an offence. However the Crimes Act section captures "omissions" whereas section 148 of the TAA does not.

The Commissioner argued that the language within section 148 was wide enough for the "omission" to act to be within the "aiding or abetting" part of the offence.

Decision

MacKenzie J giving the decision of the Court held:

Section 147 applies to a limited category of offences (committed by a body corporate) and to a limited category of persons (employees, agents or officers of the body corporate). Section 148 is a more general application and the liability it imposes may arise from the conduct of any other person. There is no necessary nexus between the two persons beyond that which creates the conduct constituting a breach of the section. Section 148 is expressly linked to all other offence provisions including section 147. **The two sections are not mutually exclusive.**

Section 148 in its use of the terms "aids, abets, incites" creates a secondary liability akin to that created by section 66(1)(b), (c) and (d) of the Crimes Act 1961. Both concepts of doing and omitting an act fall within the ordinary concepts of the word "aids". The concept of aiding is expanded on in section 66(1)(b) to apply to a person who "does or omits for the purpose of aiding". The view that section 66(1)(b) is not intended to expand the ordinary meaning of the term "aids" is consistent with section 66 being a codification of the common law concept. Section 148 of the TAA is not intended to limit the scope of "aiding" by excluding passive conduct, or an omission to act. The court also considered it worthy of note that the offence with which the company was charged (section 143A) was an act of "commission" not "omission".

Aiding does not include every omission by a person who is aware of, and has the capacity to intervene, in offending by another, *R v Coney* (1882) 8 QBD 534. The question to be asked is whether an omission to act is that of a passive spectator amounting only to non interference to prevent a crime or whether it crosses the line so as to be an omission for the purpose of aiding the commission of the offence? That is a question of fact. The appellant in taking the step of paying other creditors provided active assistance to the company in the commission of the offence.

In relation to whether or not both the principal and the company can be liable for the same offence the court found that the director's state of mind can constitute the necessary mens rea for both the liability of the company and the accessory liability of the director, *Fleming v Ellicott* [1961] NZLR 106 and *CIR v Leslie* (1985) 7 NZTC 5,101 (HC).

On the second issue of failing to act when a legal duty is imposed to act, the court found that, it is not in general terms necessary to establish a legal duty to intervene on the part of a bystander before any failure to intervene gives rise to accessory liability, *Coney*. The duties of a director to act may be relevant to a decision of whether or not they "aided or abetted" but is not decisive of it.

HIGH COURT CONSIDERS ISSUE WHEN A DIVIDEND IS PAID

Case	Commissioner of Inland Revenue v Albany Food Warehouse Ltd
Decision date	26 May 2009
Act	Income Tax Act 1994
Keywords	Paid, imputation credits

Summary

The Court held that crediting a dividend to the shareholders' accounts was sufficient to constitute payment, whether or not those funds were at the disposal of the shareholders.

Impact of decision

The impact of this judgment is that a credit in a book of account will constitute payment, whether or not the funds have actually been placed at the disposal of the payee.

Facts

On 6 June 2001, the directors of Albany Food Warehouse Ltd ("AFW") declared a dividend. The directors' resolution required that the dividend would be credited to the appropriate dividend account provided that the shareholders passed a resolution subordinating payment of the dividend to the payments of all liabilities. The shareholders passed a resolution later that morning.

The dividend was fully imputed. The dividend was declared in the morning of 6 June. In the afternoon, there was a significant change in the shareholding of the disputant resulting in a breach of shareholder continuity.

Imputation credits attached to dividends are only debited to the imputation credit account when the dividend is "paid" by the company (section ME 5(1)(a) of the Income Tax Act 1994).

Decision

The Commissioner's contention was that the dividend was not paid as no funds were placed unreservedly at the disposal of the shareholders. The Court held that the funds were paid. The extended definition of "paid" includes any amount credited. The Court considered the Oxford Dictionary definition of credit, which includes any amount entered on the credit side of a ledger. The Court held that the directors' resolutions clearly brought this dividend within that definition. The Judge stated that the resolutions had the effect of placing the funds outside the directors' control. The subordination of the dividends did not mean that crediting had not occurred. The dividend was credited to the shareholders' accounts, so had been paid within the extended definition of "paid".

Crediting the dividend amounts to the shareholders' accounts at that specific time established the shareholders' entitlement as creditors of the company. The debt that the company acknowledged was an asset for the shareholders. The Court considered that this was consistent with the general purpose of the imputation regime.

The Commissioner submitted that, even within the extended definition, the funds must be placed at the disposal of the shareholders. The Court held that the extended definition did not have to have that meaning. The Court considered that there was symmetry in holding that the dividends had been paid, because it would also mean that the shareholders would be considered to have derived income within the meaning of the Act.

RELITIGATED DECISION OF THE AUTHORITY

Case	TRA No 029/07 Decision 10/2009
Decision date	11 May 2009
Act	Income Tax Act 1994
Keywords	Relitigate, abuse of the Court's process, PAYE matter

Summary

The disputant attempted to relitigate matters already decided by the Authority. The disputant's argument was that he was remunerated inclusive of PAYE. A previous decision of the Authority found the disputant's remuneration excluded PAYE. In this proceeding the Commissioner sought to strike out the disputant's claim on the basis that this matter had already been before the Authority and decided upon by it.

Impact of decision

The decision confirms that identical matters that have been subject to previous proceedings and decided upon cannot be relitigated.

Facts

In these proceedings the disputant attempted to relitigate a previous decision of the Authority (*Case X16* (2005) 22 NZTC 12,216) relating to PAYE amounts assessed to the disputant under section NC16 of the Income Tax Act 1994.

The Commissioner applied for a strike out on the basis that the disputant's challenge is an ill-conceived attempt to relitigate matters which have been the subject of previous proceedings, and it is therefore an abuse of the Court's process.

The background to *Case X16* is as follows:

- The disputant was a Chief Executive Officer of a telecommunications group of companies in June 2000, the disputant preferred to operate as an independent contractor rather than an employee, however he had initially left his options open as to his employment status and no PAYE was deducted from his remuneration. This situation continued for the June to 31 October 2000 period. Accounts staff at the company the disputant worked for were made redundant due to the insolvency of the company, the disputant was made responsible for PAYE matters.

In *Case X16* the Authority held:

> No PAYE deductions were made by the employer in relation to salary payments made by the employer to the disputant. The disputant knew this and did nothing about the situation until the receiver of the company had been appointed and the disputant's employment contract was terminated.
>
> The disputant was responsible for non-deduction and non-payment of PAYE. He received his salary as gross income. Accordingly, it was appropriate that he be assessed for the PAYE content of his remuneration.

The Authority confirmed the Commissioner's assessments, and made adjustments amounting to $28,199.84. Following the Authority's decision, the Commissioner issued a $1,891.98 default assessment to the disputant which related to the period ending 30 June 2000. The disputant is disputing this assessment in this present proceeding.

Decision

The Authority held that PAYE was not deducted from payments made to the disputant by his employer company. Therefore, the disputant was personally liable for the PAYE under section NC16 of the Act.

The disputant's employer failed to make any PAYE deduction. That aspect was simply not attended to, and the disputant knew that, and that the employer did not have funds available for PAYE on the disputant's salary. Also, there is considerable vagueness as to whether the disputant's salary payments were intended to be on an employment basis or independent contractor basis, and whether or not they were meant to be net of tax.

The Authority had already made similar findings against the disputant in relation to the PAYE periods ended 31 July 2000 to 31 October 2000. As reported in *Case X16*, similar findings were also made in relation to the June 2000 period.

At the strike-out hearing, the Authority allowed the disputant to file further evidence in support of his position that PAYE was deducted from payments made to him by his employer company. The Authority went on to say that filing further evidence would not, and could not, lead to the reopening of the other periods (31 July 2000 to 31 October 2000) and that the disputant could only rely on further evidence for the period ending 20 June 2000.

New evidence did not disclose any new matters which would make a material difference to the Authorities previous decision in *Case X16*.

The Commissioner's position is that PAYE has never been paid by the disputant's employer and section NC16 applies and makes the disputant, liable to the Commissioner for PAYE. The Authority agreed with the Commissioner and found that the disputant's challenge is an ill-conceived attempt to relitigate matters which have been the subject of previous proceedings, and is therefore an abuse of the Court's process.

QUESTIONS WE'VE BEEN ASKED

QB 09/04: THE RELATIONSHIP BETWEEN SECTION 113 OF THE TAX ADMINISTRATION ACT 1994 AND THE PROVISO TO SECTION 20(3) OF THE GOODS AND SERVICES TAX ACT 1985 WHEN A REGISTERED PERSON HAS NOT CLAIMED AN INPUT TAX DEDUCTION IN AN EARLIER TAXABLE PERIOD

We have been asked to clarify the relationship between section 113 of the Tax Administration Act 1994 ("section 113") and the proviso to section 20(3) of the Goods and Services Tax Act 1985 ("the proviso to section 20(3)") when a registered person ("taxpayer") has not claimed a goods and services tax ("GST") input tax deduction in an earlier taxable period.

In particular, we have been asked whether the Commissioner is required to amend a GST assessment under section 113 to allow a deduction in an earlier taxable period when, under the proviso to section 20(3), the taxpayer can claim a GST input tax deduction in a later taxable period.

We have also been asked to explain the effect of the two-year limitation period specified in paragraph (a) of the proviso to section 20(3).

While the Commissioner is not prevented from exercising the discretion under section 113, the Commissioner's practice is generally not to do so. This is because the proviso to section 20(3) provides a specific mechanism by which taxpayers can correct the failure to claim the input tax deduction themselves. It is the Commissioner's view that a general provision such as section 113 should not be used when a specific provision is available.

However, in certain circumstances the Commissioner will consider exercising the discretion under section 113 and amend the earlier GST assessment, notwithstanding that the taxpayer can alternatively claim a GST input tax deduction in a later period.

Background

The proviso to section 20(3) allows a taxpayer to include a GST input tax deduction not claimed in an earlier return period in a later return period without having to issue a notice of proposed adjustment ("NOPA") to the Commissioner.

The proviso to section 20(3) reads:

> Provided that a registered person who is entitled to deduct an amount from the output tax attributable to a taxable period may deduct that amount from the output tax attributable to a later taxable period if the amount has not previously been deducted from the output tax of the registered person and—
>
> (a) the later tax period begins on or before the date that is the 2nd anniversary of the earlier of the following:
>
> (i) the date on which the registered person makes the payment for the taxable supply to which the deduction relates:
>
> (ii) the date on which a tax invoice is issued for the taxable supply to which the deduction relates:
>
> (b) the failure of the registered person to make the deduction in the earlier taxable period arises from—
>
> (i) an inability of the registered person to obtain a tax invoice:
>
> (ii) a dispute over the proper amount of the payment for the taxable supply to which the deduction relates:
>
> (iii) a mistaken understanding on the part of the registered person that the supply to which the deduction relates was not a taxable supply:
>
> (iv) a clear mistake or simple oversight of the registered person.

Paragraphs (a) and (b) of the proviso to section 20(3) set out the criteria that apply if a registered person who has not claimed a GST input tax deduction in one taxable period seeks to claim the input tax deduction in a later taxable period. Paragraphs (a) and (b) are not cumulative requirements. They are separate criteria and they apply independently.

Under paragraph (a) a taxpayer has an unqualified two-year period within which a GST input tax deduction omitted from an earlier taxable period can be claimed in a later taxable period. Paragraph (a) sets out the mechanism for determining the two-year limitation period. That is, the period that ends on the second anniversary of the earlier of the payment date or date that the tax invoice was issued for the taxable supply to which the omitted input tax deductions relate.

Paragraph (b) prescribes four potential circumstances when a taxpayer could have failed to claim a GST input tax deduction in an earlier taxable period. If any of the circumstances specified in paragraph (b) apply, the taxpayer will have an unlimited time to claim the input tax deductions in a later taxable period.

The four circumstances specified in paragraph (b) apply independently. That is, the taxpayer does not have to prove that their failure to claim an input tax deduction in an earlier GST period arises because all the circumstances specified in paragraph (b) have occurred.

On the other hand, section 113 gives the Commissioner the discretion to amend an assessment to ensure its correctness when it contains an error.

Section 113 reads:

> (1) Subject to sections 89N and 113D, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.
>
> (2) If any such amendment has the effect of imposing any fresh liability or increasing any existing liability, notice of it shall be given by the Commissioner to the taxpayer affected.

Discussion

We have been asked whether the proviso to section 20(3) takes precedence over section 113 when a taxpayer has not claimed a GST input tax deduction in an earlier taxable period.

Inland Revenue's practice for exercising the Commissioner's discretion to amend an assessment under section 113 is set out in SPS 07/03: *Requests to amend assessments*.

SPS 07/03 states that:

> The discretion to amend assessments under section 113 enables the Commissioner to act fairly towards all taxpayers including those who get their tax returns or assessments correct the first time and those who have made genuine errors. This also promotes integrity in the administration of the tax system.
>
> It is important, however, to recognise that Inland Revenue does not have unlimited resources to undertake lengthy verification processes to determine whether assessments should be amended. When meeting the obligation to collect over time the highest net revenue that is practicable within the law under section 6A(3), the Commissioner must consider:
>
> (a) the resources available to the Commissioner,
>
> (b) promoting compliance, especially voluntary compliance, by all taxpayers, and
>
> (c) taxpayers' compliance costs.
>
> Accordingly, it is consistent with the obligation under section 6A(3) for the Commissioner to limit the amount of time and other resources that will be spent investigating amendment requests. Therefore, at times not all requested amendments will necessarily be corrected. Ensuring a balance between time spent considering amendment requests and other activities is also consistent with the obligation to protect the integrity of the tax system under section 6(1).

Although the Commissioner is not prevented from exercising the discretion under section 113, if the taxpayer can alternatively claim a GST input tax deduction pursuant to the proviso of section 20(3), the Commissioner's practice is generally to not exercise the discretion under section 113.

This is because the proviso to section 20(3) provides a specific mechanism by which the taxpayer can correct the failure to claim the input tax deduction themselves. As such, it is not necessary for the taxpayer to request that the Commissioner amends the assessment under section 113 to claim the input tax deduction.

However, in certain circumstances the Commissioner will exercise the discretion under section 113 notwithstanding that the taxpayer can alternatively claim a GST input tax deduction in a later period. Examples of circumstances where the Commissioner will consider amending the GST assessment under section 113 include if:

- the tax position taken by the taxpayer that input tax was not deductible in the earlier period was adopted on the basis of incorrect advice given by Inland Revenue; or
- the Commissioner is already investigating the earlier period to which the GST input tax deduction relates.

Any request for an amendment to the original GST assessment made under section 113 must be considered in terms of Inland Revenue's practice for exercising the Commissioner's discretion to amend assessments under that section, as set out in SPS 07/03: *Requests to amend assessments*.

If a taxpayer is unable to claim the input tax deduction in a later period due to the elapse of the two year limitation period specified in paragraph (a) of the proviso to section 20(3) and paragraph (b) of the proviso does not apply, the Commissioner will consider a request to amend the original GST period under section 113. However, any such request must also comply with the requirements set out in SPS 07/03: *Requests to amend assessments*.

SPS INV 490: Correcting minor errors in GST returns

The question of correcting minor GST errors in subsequent GST returns was previously considered in SPS INV 490: *Correcting minor errors in GST returns*. SPS INV 490 has now been withdrawn. Taxpayers seeking to correct errors made in GST returns should now refer to this item and to SPS 07/03: *Requests to amend assessments*.

QB 09/05: RESIDENTIAL INVESTMENT PROPERTY OR PROPERTIES IN AUSTRALIA OWNED BY NEW ZEALAND RESIDENT – NRWT TREATMENT OF INTEREST PAID TO AUSTRALIAN FINANCIAL INSTITUTION

Income Tax Act 2007, section YD 4(11)(b)(i) – Interest deemed to be derived from New Zealand

Double Taxation Relief (Australia) Order 1995, Schedule, Article 11 – Taxation of interest

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

Background

The Commissioner has been asked to clarify Inland Revenue's position on whether New Zealand residents who borrow money from Australian financial institutions to purchase residential investment properties in Australia are liable for non-resident withholding tax (NRWT) on the interest payable. Articles have appeared in the media regarding this issue over recent years, and there has been uncertainty as to how the domestic legislation and the double tax agreement ("DTA") with Australia apply.

Question

If you own one or more residential investment properties in Australia and you have borrowed money from an Australian financial institution to purchase the property or properties, do you have to pay NRWT on the interest paid to the Australian financial institution?

Different fact situations could arise in respect of this question. This item considers the two most common situations, where:

(a) you manage the property or properties yourself (situation A); and

(b) a property manager in Australia manages the property or properties for you (situation B).

Answer

In every case, you will need to consider your own particular fact situation. However, in general terms the following applies.

1. If the Australian financial institution to which you pay interest has a branch in New Zealand, in both situations A and B the NRWT rules **will not** apply to the interest because the financial institution has a fixed establishment in New Zealand.

   It is important to note that some Australian financial institutions that operate in New Zealand do so through subsidiaries rather than through branches. The NRWT rules **will apply** if the Australian financial institution from which you borrowed money in Australia operates in New Zealand only through a subsidiary, i.e. it does not also have a branch in New Zealand. If you borrow from a New Zealand subsidiary of an Australian financial institution no NRWT issues will arise, however, because the interest is not paid to a non-resident. If you wish to check which financial institutions operate as branches in New Zealand go to the Reserve Bank website (www.rbnz.govt.nz/nzbanks).

2. If the Australian financial institution to which you pay interest does not have a branch in New Zealand, the outcomes between situations A and B may differ.

   Situation A

   Under situation A, if you manage the property or properties in Australia from New Zealand, you will have to pay NRWT on the interest whether or not you are in the business of leasing, because you will not have a fixed establishment or a permanent establishment in Australia.

   Situation B

   Under situation B, if you have more than one residential investment property in Australia, you may have a fixed establishment in Australia. If you do have a fixed establishment in Australia, then you will not have to pay NRWT on the interest.

   If you employ a property manager who:

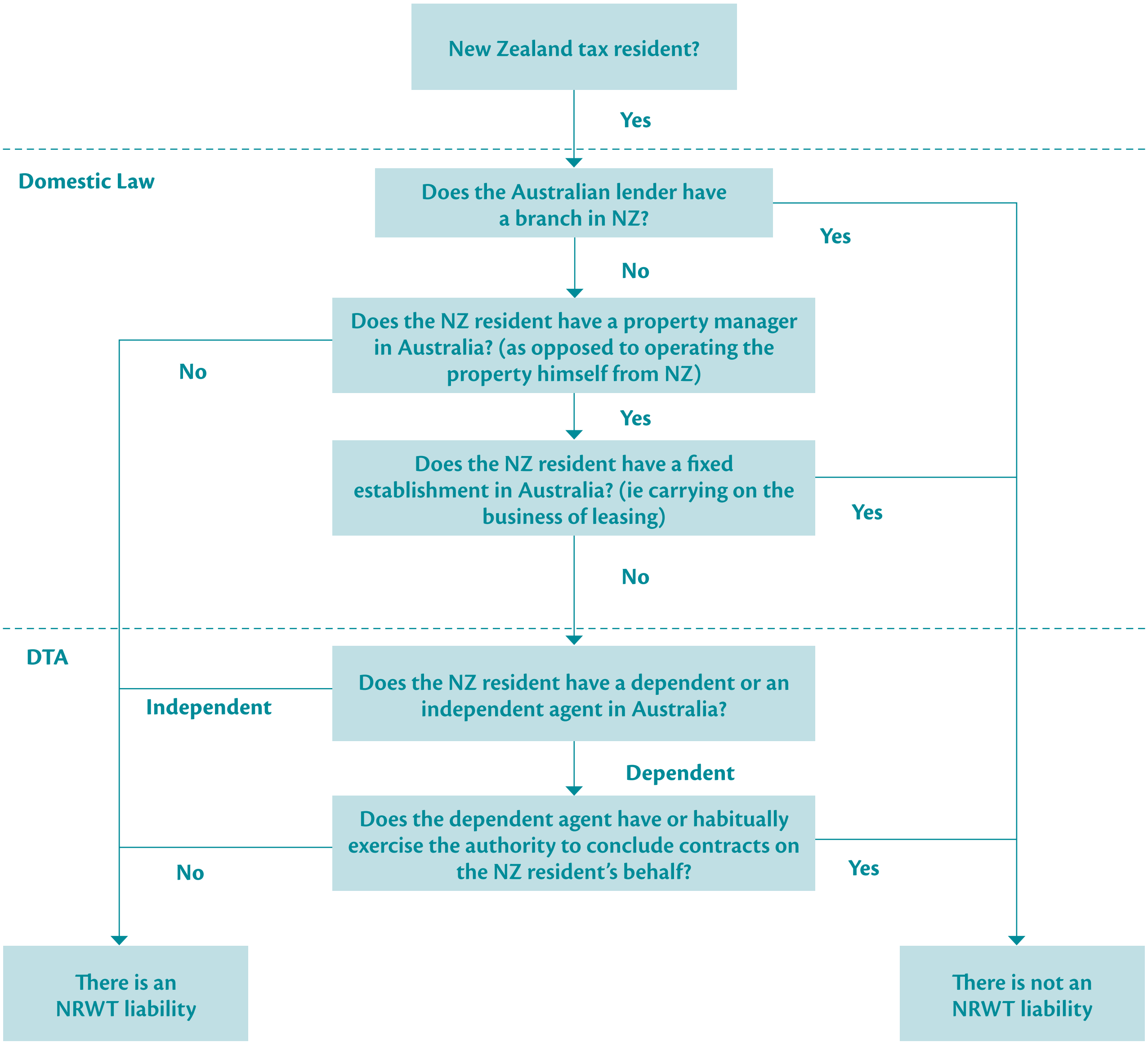
   - works as a property manager only for you; and
   - has and habitually exercises the authority to enter contracts on your behalf

   then you **will not** have to pay NRWT on the interest because the property manager will be a dependent agent and you will be deemed to have a permanent establishment in Australia. As you borrowed the funds to purchase the property or properties, there is sufficient connection between the permanent establishment and the indebtedness and the DTA will apply.

   If the property manager acts for you in the ordinary course of their business and is able to act independently of you, it is likely the property manager will be an independent agent and you **will** have to pay NRWT on the interest because you will not have a permanent establishment in Australia.

The following flowchart sets out the questions that need to be answered to determine NRWT liability.

Flowchart for determining NRWT liability



For further information on the payment of NRWT, see the two Inland Revenue guides *Non-resident withholding tax – payer's guide (IR 291)* and *NRWT reconciliation statement guide (IR 67SG)*.

Transitional residents

If you have become a New Zealand resident since 1 April 2006 and were non-resident here for a continuous period of at least ten years prior to becoming resident, you may qualify as a "transitional resident" under section HR 8 of the Income Tax Act 2007.

If you qualify as a transitional resident and you pay interest in relation to money borrowed when you were not a New Zealand resident, the amount of NRWT you need to withhold is zero.

You are a transitional resident for four years after you become resident in New Zealand. After that four-year period, you must withhold NRWT at the generally applicable rate (currently 10%).

You may make an irrevocable election not to be a transitional resident (see section HR 8(4) of the Income Tax Act 2007).

Penalties and interest

As the person who pays the interest to the Australian financial institution, you are required to withhold the NRWT and pay it to the Commissioner of Inland Revenue. If you fail to do so, use of money interest, late payment penalties and/or shortfall penalties ranging from 20% to 150% could be imposed on you.

For more information on these penalties, see the Inland Revenue guides *Late payment and late filing penalties (IR 741)* and *Taxpayer obligations, interest and penalties (IR 240)*.

Approved issuer levy

If you are liable to pay NRWT, for the future you could request approval from Inland Revenue to become an approved issuer and have the loan treated as a registered security. You then pay the approved issuer levy of 2% instead of NRWT at 10%.

You will be granted approved issuer status if you have complied with your requirements under all of the Inland Revenue Acts during the two years before you made your application. You must then register all relevant securities with Inland Revenue. Approved issuer status cannot be backdated.

For further information, see the Inland Revenue guide *Approved issuer levy: A guide for payers (IR 395).*

Analysis

The NRWT rules apply to gross income deemed to be derived from New Zealand that consists of interest (see section RF 2(1) of the Income Tax Act 2007).

Section YD 4(11)(b)(i) of the Income Tax Act 2007 provides that interest derived from money lent outside New Zealand to a New Zealand resident is derived from New Zealand unless the resident borrows the money for a business carried on through a fixed establishment outside New Zealand.

However, in three instances NRWT will not be payable. The first two are provided by the domestic legislation. Section RF 2(1) of the Income Tax Act 2007 provides that if the Australian financial institution to which the interest is paid operates through a fixed establishment (ie a branch) in New Zealand, the NRWT rules do not apply. Section YD 4(11)(b)(i) of the of the Income Tax Act 2007 provides a further exception that applies if the resident borrows the money for a business carried on through a fixed establishment outside New Zealand. The third instance where NRWT will not be payable is if relief is provided by the DTA. The Australian DTA provides no NRWT will be payable if the New Zealand resident has a permanent establishment in Australia.

Section YD 4(11)(b)(i) applies to you even if you were not a New Zealand resident when you borrowed the money in respect of which you now pay interest from New Zealand. This is because the underlying policy of the provision is that the money used to pay the interest is raised through economic activity in New Zealand—the country in which the payer of the interest now resides—and the person is using public facilities here as a resident, so therefore the interest should be taxed in New Zealand. There is an exception to this general rule though, which is that if you borrowed the money for a business carried on through a fixed establishment outside New Zealand, then the interest is not considered to be sourced in New Zealand. In those circumstances, there is an economic link with the other country through the use of the money in the business carried on there. This is consistent with international treaty practice and is reflected in the DTA provisions discussed in this item.

The transitional residents provisions (referred to above) were introduced to mitigate the effect of the requirement for new New Zealand residents to withhold NRWT in relation to interest paid on money borrowed prior to gaining residency. The provisions were one of the legislative amendments that resulted from the government discussion document *Reducing tax barriers to international recruitment to New Zealand* published in November 2003.

Terminology

The term "fixed establishment" is used in New Zealand's domestic legislation and is defined in section YA 1 of the Income Tax Act 2007.

The term "permanent establishment" is defined in Article 5 of the DTA.

The two terms are used to describe types of business arrangements and can affect a person's tax position, including whether or not the interest paid to an Australian financial institution is subject to the NRWT rules in New Zealand.

A fixed establishment and a permanent establishment have similar features but a fixed establishment requires a substantial business to be carried on.

Australian financial institution has a branch in New Zealand – situations A and B

If the Australian financial institution to which the interest is paid operates through a fixed establishment (ie a branch) in New Zealand, the NRWT rules will not apply to the interest (see section RF 2(1) of the Income Tax Act 2007).

Australian financial institution has no branch in New Zealand – situation A

In terms of the definitions of "fixed establishment" and "permanent establishment", a property or properties managed by a New Zealand resident ("the New Zealand owner") from New Zealand cannot constitute a "fixed place of business". The property (ie an apartment or house) is a fixed place but the business of leasing is not carried on through or in that place. All the management of the business takes place in New Zealand. The property itself is not where the business is carried on, rather it is the *subject* of the business.

If the lessee carries on a business from the rental property, then the property is the lessee's fixed place of business, not the lessor's. The property is not available to the lessor (the New Zealand owner) throughout the period of the lease, so cannot constitute a fixed establishment or a permanent establishment of the New Zealand owner. The business of leasing is carried on elsewhere; that is, on the facts described above, in New Zealand. This means the exception to NRWT provided by the domestic legislation does not apply.

If the New Zealand owner makes regular trips to Australia to carry out management activities in respect of the residential investment property but carries out those activities from a motel or hotel, there is no fixed place of business—a rented room in such circumstances lacks the required permanence to be a "fixed" place of business. In addition, the business of leasing is not limited to the period when the New Zealand owner is operating in Australia, the New Zealand owner is still required to deal with management issues from New Zealand from time to time.

Australian financial institution has no branch in New Zealand – situation B

Fixed establishment

If a fixed establishment exists, section YD 4(11)(b)(i) of the Income Tax Act 2007 will not apply and the interest will not be deemed to be derived from New Zealand. Therefore, the New Zealand owner **will not** be liable for NRWT on interest paid.

Unlike the permanent establishment definition in the DTA (discussed below), the definition of "fixed establishment" does not include any provisions relating to the use of dependent or independent agents. However, general principles of agency can still be applied. A fixed establishment will be found to exist only if there is a fixed place of business in Australia through which a substantial business is carried on. The residential property is not itself a fixed place in which the business is carried on; rather it is the *subject* of the business.

If the property manager is working for the New Zealand owner as their agent and has a fixed place in Australia from where that activity takes place, it could be considered that the business of leasing is carried on through that place and that the New Zealand owner has a fixed establishment in Australia.

However, if the New Zealand owner owns only one property that a property manager manages in Australia, a fixed establishment will generally not exist, as the leasing of one property will generally not amount to a "substantial business". However, this will depend on the nature of the single property: for example, if the single property is an apartment block, the leasing of it may be a substantial business.

If the New Zealand owner owns more than one property, whether there is a substantial business (and therefore a fixed establishment) will depend on the particular facts. It is more likely that there will be a substantial business of renting (and hence a fixed establishment) where several properties are rented out.

While the decided cases (such as *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1978] 3 All ER 1185 (PC) and *LD Nathan Group Properties Ltd v CIR* (1980) 4 NZTC 61,602) do indicate that a business may be more readily found to exist where a rental property or properties is owned by a company (rather than an individual), this will still depend upon the particular circumstances of the case. In addition, for there to be a fixed establishment any such business must be a *substantial* business.

Permanent establishment

If the property manager is a "dependent agent" (see Article 5(7) of the DTA), a permanent establishment will exist and NRWT **will not** be payable by the New Zealand owner provided the indebtedness is attributable to the permanent establishment and the interest is deductible in determining the profits of the permanent establishment (see Article 11(5) of the DTA).

A dependent agent of the New Zealand owner is one who is acting solely for the New Zealand owner and who has and habitually exercises the authority to enter contracts on the New Zealand owner's behalf. Such an agency makes it likely that the New Zealand owner will be deemed to have a permanent establishment under the DTA.

If a permanent establishment exists, the DTA requires that there be a connection between the permanent establishment and the indebtedness in respect of which the New Zealand owner pays interest. As the New Zealand owner borrowed the funds to purchase the property or properties, and the property manager works for the New Zealand owner in respect of that property, a sufficient connection exists between the permanent establishment and the indebtedness, so the DTA will apply.

However, if the property manager is acting in the ordinary course of their own business of managing properties and is independent of the New Zealand owner legally and economically, the New Zealand owner will likely not be deemed to have a permanent establishment. This is so because the property manager will be an independent agent and any interest **will** be subject to NRWT.

If the property manager acts solely for the New Zealand owner in respect of the rental property but also owns another business *unrelated* to the property management business, the manager could still be considered a dependent agent of the New Zealand owner. The DTA expressly excludes an agent who acts for the New Zealand owner in the *ordinary course* of the agent's own property management business from being a dependent agent. However, a person who operates a business of their own (which is not related to property management) and who acts for the New Zealand owner *outside* the ordinary course of that business is able to be considered a dependent agent of the New Zealand owner, if such person has and habitually exercises the authority to enter into contracts on behalf of the New Zealand owner.

Note also that the New Zealand owner is not deemed to have a permanent establishment in Australia under Article 5(4)(c) of the DTA. A residential property does not constitute substantial equipment within the meaning of this provision.

Example 1

Mr Acorn, a New Zealand resident, purchases a residential property on the Gold Coast in Australia as an investment. To finance the purchase, Mr Acorn takes out a loan with the Commonwealth Bank of Australia that is secured by a mortgage over the residential property.

The Commonwealth Bank of Australia operates in New Zealand through a branch. Consequently, the bank is considered to have a fixed establishment in New Zealand and the NRWT rules will not apply to require Mr Acorn to deduct a withholding payment from the interest paid on the loan to the bank.

Example 2

Mr Smith, a New Zealand resident, purchases a residential property on the Gold Coast in Australia as an investment. To finance the purchase, Mr Smith takes out a loan with the National Australia Bank that is secured by a mortgage over the residential property.

Mr Smith manages the residential property from his home in New Zealand and organises for maintenance work to be carried out as necessary when advised by his tenants. He does not engage the services of any person to act on his behalf in Australia in relation to the property.

National Australia Bank does not operate through a branch in New Zealand, so does not have a fixed establishment here. Mr Smith will have to deduct NRWT from the interest payments that he makes to the bank and pay them to Inland Revenue.

Mr Smith could request Inland Revenue's approval to become an approved issuer and have his mortgage accepted as a registered security. If accepted, Mr Smith would pay a 2% levy in place of NRWT at 10% from the date of acceptance.

Example 3

Ms Worth, a New Zealand resident, purchases 10 apartments in a high-rise apartment tower on the Gold Coast in Australia. She finances the purchases by borrowing funds from National Australia Bank. The loans are secured by mortgages over each of the properties.

Ms Worth does not have time to manage the properties herself from New Zealand, so she engages an acquaintance, Mr Donald, who lives on the Gold Coast, to manage them on her behalf. Mr Donald is retired and undertakes this management role only for Ms Worth. She authorises him to enter into contracts (i.e. tenancy agreements and maintenance contracts) on her behalf, and he does so regularly.

National Australia Bank does not operate through a branch in New Zealand, so does not have a fixed establishment here. However, because Mr Donald has and habitually exercises the authority to enter contracts on behalf of Ms Worth and works as a property manager only for her Mr Donald will be considered a dependent agent. Therefore, Ms Worth will have a permanent establishment in Australia and will not have to deduct NRWT from the interest payments made to National Australia Bank.

Example 4

Mrs King, a New Zealand resident, purchases two apartments in a high-rise apartment tower on the Sunshine Coast in Australia. She finances the purchases by borrowing funds from National Australia Bank. The loans are secured by mortgages over each of the properties.

Mrs King does not have time to manage the properties herself from New Zealand so she engages a professional property manager, Mr James, to manage the properties on her behalf. Mr James runs his own property management business on the Sunshine Coast, catering to non-resident owners of property in his area. Mrs King authorises Mr James to enter into contracts (i.e. tenancy agreements and maintenance contracts) on her behalf, and Mr James does so regularly.

National Australia Bank does not operate through a branch in New Zealand, so does not have a fixed establishment here. Mr James operates his own property management business and acts for Mrs King in the ordinary course of that business. Therefore, Mr James is an independent agent. Mrs King will not have a permanent establishment in Australia. Mrs King will not have a fixed establishment either, because, even if she could be considered to be in business through the activities of her agent, the leasing of two properties does not amount to a substantial business. Mrs King will have to deduct NRWT from the interest paid to the bank and pay the NRWT to Inland Revenue.

Previous legislation

The Commissioner considers that the legal position outlined in this item was the same under the previous income tax legislation.

Other countries

This item, and the underlying analysis, may also apply to the NRWT liability of New Zealand residents who own investment properties in countries other than Australia, where the purchase of such properties has been financed by a loan from a financial institution in that country. The general principles relating to New Zealand's domestic legislation will apply. However, it is important to note that the outcome may differ because the relevant provisions of New Zealand's double tax agreement with that country may not be the same as those considered in this item.

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Office of the Chief Tax Counsel

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

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