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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 6140

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED0131	Draft determination: Tax depreciation rates general determination	This draft depreciation determination advises a proposed general depreciation rate for campervans and motorhomes.	30 November 2010
SPS ED0124	Instalment arrangements for payment of tax debt	The draft SPS sets out Inland Revenue's proposed practice for providing financial relief by way of an instalment arrangement when taxpayers are in debt.	14 January 2011
SPS ED0129	Child support debt – requesting an instalment arrangement	The draft SPS sets out Inland Revenue's practice on providing relief in the form of an instalment arrangement to pay debt, when immediate payment of an overdue child support obligation is not possible.	14 January 2011
SPS ED0130	Student loans – relief from repayment obligations	The draft SPS sets out Inland Revenue's practice on providing relief from payment of student loan repayment obligations.	14 January 2011
SPS 08/04 Appendix A	Industry specific balance date for kiwifruit orchardists	As a consequence of earlier harvest seasons being experienced by kiwifruit orchardists and new earlier fruiting varieties of kiwifruit being developed, Inland Revenue has been asked to review the current industry specific balance dates for kiwifruit orchardists.	13 December 2010

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This is a brief background explaining the changes made to the statement since it was last issued in draft form for consultation.

IS 10/07: Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994

This Interpretation Statement sets out the Commissioner's position on his responsibility under section 6A(2) of the Tax Administration Act 1994 for the "care and management of the taxes covered by the Inland Revenue Acts", and his duty under section 6A(3) of the TAA "to collect over time the highest net revenue that is practicable within the law".

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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**

BR PUB 10/10–10/13: LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS – GOODS AND SERVICES TAX IMPLICATIONS

PUBLIC RULING BR PUB 10/10: LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES HAVE BEEN PAID BEYOND SETTLEMENT – GOODS AND SERVICES TAX IMPLICATIONS FOR VENDOR

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 sections 8 and 10 and the definition of "consideration" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered vendor and a GST-registered or unregistered purchaser. The vendor has prepaid local authority rates beyond the date of settlement of the transaction. The vendor is supplying the property in the course or furtherance of its taxable activity.

Because the rates have been prepaid, the settlement statement apportions the rates between the vendor and the purchaser. On the settlement date the purchaser is required to pay its share of the rates paid by the vendor, in addition to the purchase price for the real estate.

Section 14(1)(d) does not apply to the supply of the property.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The payment by the purchaser for its apportioned share of the prepaid rates (covering the period from the time of settlement) will be part of the "consideration" (as defined in section 2(1)) for the supply of the property by the vendor.
- Under section 8, GST is chargeable on the supply of the property by a registered vendor by reference to the value of the supply. The value of that supply under section 10(2) will include the purchase price and the amount of the prepaid rates apportionment paid by the purchaser to the vendor.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 23 September 2010 and ending on 23 September 2015.

This Ruling is signed by me on the 23rd day of September 2010.

Susan Price

Director, Public Rulings

PUBLIC RULING BR PUB 10/11: LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES HAVE BEEN PAID BEYOND SETTLEMENT – GOODS AND SERVICES TAX IMPLICATIONS FOR PURCHASER

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 sections 8 and 10 and the definition of "consideration" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered or unregistered vendor and a GST-registered purchaser. The vendor has prepaid local authority rates beyond the date of settlement of the transaction. The purchaser is acquiring the property for the principal purpose of making taxable supplies.

Because the rates have been prepaid, the settlement statement apportions the rates between the vendor and the purchaser. On the settlement date the purchaser is required to pay its share of the rates paid by the vendor, in addition to the purchase price for the real estate.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The payment by the purchaser for its apportioned share of the prepaid rates (covering the period from the time of settlement) will be part of the "consideration" (as defined in section 2(1)) for the supply of the property by the vendor.
- If the purchaser is entitled to an input tax deduction for the supply of the property then the purchaser can claim an input tax deduction on the total amount of consideration for the supply.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 23 September 2010 and ending on 23 September 2015.

This Ruling is signed by me on the 23rd day of September 2010.

Susan Price

Director, Public Rulings

PUBLIC RULING BR PUB 10/12: LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES ARE IN ARREARS – GOODS AND SERVICES TAX IMPLICATIONS FOR VENDOR

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 sections 8 and 10 and the definition of "consideration" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered vendor and a GST-registered or unregistered purchaser. The local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding amount. The vendor is supplying the property in the course or furtherance of its taxable activity.

Because the rates are in arrears and the parties have agreed that the purchaser will pay the outstanding amount to the local authority, the settlement statement provides a credit to the purchaser for the vendor's share of the outstanding amount.

Section 14(1)(d) does not apply to the supply of the property.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Where the vendor allows a credit against the purchase price for unpaid rates, the consideration (as defined in section 2(1)) for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
- Under section 8, GST is chargeable on the supply of the property by a registered vendor by reference to the value of the supply. The value of the supply under section 10(2) will include the amount received by the vendor from the purchaser as well as the amount of the outstanding local authority rates that the purchaser has agreed to discharge.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 23 September 2010 and ending on 23 September 2015.

This Ruling is signed by me on the 23rd day of September 2010.

Susan Price

Director, Public Rulings

PUBLIC RULING BR PUB 10/13: LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES ARE IN ARREARS – GOODS AND SERVICES TAX IMPLICATIONS FOR PURCHASER

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 sections 8 and 10 and the definition of "consideration" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered or unregistered vendor and a GST-registered purchaser. The local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding amount. The purchaser is acquiring the property for the principal purpose of making taxable supplies.

Because the rates are in arrears and the parties have agreed that the purchaser will pay the outstanding amount to the local authority, the settlement statement provides a credit to the purchaser for the vendor's share of the outstanding amount.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Where the vendor allows a credit against the purchase price for unpaid rates, the consideration (as defined in section 2(1)) for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
- If the purchaser is entitled to an input tax deduction in respect of the supply of the property then the purchaser can claim an input tax deduction on the total amount of consideration for the supply.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 23 September 2010 and ending on 23 September 2015.

This Ruling is signed by me on the 23rd day of September 2010.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 10/10 TO BR PUB 10/13

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 10/10, BR Pub 10/11, BR Pub 10/12 and BR Pub 10/13 ("the Rulings").

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

Summary

1. The Rulings address the question of how apportionments of local authority rates made in property transactions should be treated for GST. BR Pub 10/10 and BR Pub 10/11 apply to situations where the rates have been prepaid by the vendor beyond the settlement date. BR Pub 10/12 and BR Pub 10/13 apply to situations where the local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding rates, in exchange for a credit against the settlement amount for the vendor's share of the outstanding rates.
2. This commentary explains the conclusions reached in the Rulings. After providing a brief introduction and setting out the relevant legislation, this commentary discusses:
    - **Consideration for a supply:** this part of the commentary discusses key principles regarding "consideration"—namely that "consideration" has a wide meaning and that a statutory obligation to a third party does not amount to "consideration".
    - **GST treatment of transactions where the rates are prepaid:** this part of the commentary explains the GST treatment where the rates have been prepaid beyond settlement. It explains that the payment of the rates apportionment to the vendor by the purchaser forms part of the total consideration for the supply of the property.
    - **GST treatment of transactions where the rates are in arrears:** this part of the commentary explains the GST treatment where the rates are in arrears at settlement and the vendor allows a credit against the purchase price for unpaid rates. It explains that the consideration for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
3. After the legal analysis, the commentary provides examples of a range of different property sale situations. The examples include discussion of how the Rulings apply to each situation as well as model settlement statements and tax invoices.

Introduction

4. Section 5(7) requires local authorities to charge GST on rates.
5. Local authorities (that is, city and district councils and some regional councils) charge ratepayers rates in advance under the Local Government (Rating) Act 2002. On the sale and purchase of land, a vendor may pass on to a purchaser rates that relate to the period of the purchaser's occupation of the land. Apportionment is usually provided for in the sale and purchase contract.
6. Confusion exists about whether the GST-inclusive or GST-exclusive rates amount should be apportioned and whether vendors should seek to recover a GST-inclusive rates amount from purchasers. The Rulings, and this commentary, seek to remove this confusion by explaining the effect of the rates apportionment on the amount of consideration the vendor receives.
7. Public Ruling BR Pub 99/8, "Local authority rates apportionments on property transactions – goods and services tax treatment", *Tax Information Bulletin* Vol 11, No 11 (December 1999), expired on 31 March 2003. BR Pub 99/8 applied to a sale and purchase of land where the parties to the transaction apportioned local authority rates between themselves. It did not differentiate in the ruling itself between situations where rates had been prepaid and situations where rates were in arrears, as occurs in these Rulings.

Legislation

Goods and Services Tax Act 1985

8. "Consideration" is defined in section 2(1) to mean:

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

9. "Dwelling" is defined in section 2(1) to mean:

    > any building, premises, structure, or other place, or any part thereof, used predominantly as a place of residence or abode of any individual, together with any appurtenances belonging thereto and enjoyed with it; but does not include a commercial dwelling.

10. Section 5(7)(a) states:

    For the purposes of this Act—

    (a) every local authority is deemed to supply goods and services to any person where any amount of rates is payable by that person to that local authority.

11. Section 5(15) states:

    Where a dwelling is included in a supply, the supply of that dwelling is deemed to be a separate supply from the supply of any other real property included in the supply.

12. Section 8(1) states:

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

13. Section 10(2) defines "value of supply" as follows:

    Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—

    (a) to the extent that the consideration for the supply is consideration in money, the amount of the money:

    (b) to the extent that the consideration for the supply is not consideration in money, the open market value of that consideration.

How the legislation applies

14. This part of the commentary explains the reasoning behind the Rulings. It begins by outlining some general principles regarding "consideration". Following this, it discusses in turn the two different situations to which the Rulings apply – where rates are prepaid and where rates are in arrears. Finally, this part of the commentary considers the effect of section 5(15) on the application of the Rulings.

Consideration for a supply

General principles

15. The legislation and case law have established some key principles regarding "consideration". Three principles are that:

    - the statutory meaning of "consideration" is wider than the contract law meaning;
    - any consideration need not be voluntary; and
    - the supply need not be made by the person who receives the payment.

16. However, for a payment to be "consideration" there must be a sufficient relationship between the making of the payment and the supply of goods and services.

Wide definition of "consideration"

17. "Consideration" is very widely defined in the Act. In section 2(1), the definition of "consideration", in relation to the supply of goods and services to any person, includes any payment made whether by that person (the recipient of the supply) or by any other person. Therefore, consideration is not limited to payments made by the recipient of the supply.

18. It is also not crucial that the payment be made to the supplier; it is sufficient that the payment (or any act of forbearance if that were relevant) be made in respect of, in response to, or for the inducement of the supply. Accordingly, if A makes a supply of goods and services to B, and in response at the request of A, B pays an amount of money to C, then there is still an amount of consideration for the supply of goods and services.

19. Consideration may also be voluntary or involuntary.

Statutory obligation to a third party does not amount to "consideration"

20. Where the recipient of a supply is required by law to undertake an obligation to a third party, then any discharge of that obligation by the recipient is not the provision of consideration for the supply: T*he Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076; *Iona Farm Ltd v CIR* (1999) 19 NZTC, 15,261.

21. In *Trustee, Executors and Agency Co* the High Court found that the payment of rates by a lessee constituted part of the consideration for the supply of land by way of lease. An important part of that conclusion was Chisholm J's finding that the **lessor** trust was the occupier of the farm property. Therefore, the lessor trust was primarily liable for rates levied against the farm. The lessee had no statutory obligation to pay the rates. Therefore, the lessee's payment of the rates to the local authority constituted a payment on behalf of the trust and was part of the consideration for the supply.

22. In the later decision *Iona Farm Ltd* Young J in the High Court found that the open market rental (the relevant concept for determining the consideration for the supply in that case) for a farm exceeded the GST-registration threshold. The threshold was exceeded without taking into account any rates that the lessee was paying. Even so, his Honour noted that the Commissioner had sought to suggest that the rates that the lease required the lessees to pay should be treated as part of the consideration for the lease, relying on the decision in *Trustee, Executors and Agency Co*. His Honour noted that the lease in Iona Farm was for a period longer than 12 months, so the primary

[1] This will change to 15 percent on 1 October 2010 with application to supplies made on or after 1 October 2010.

rating liability lay on the lessee (and not the lessor). In that respect, the case was distinguishable from the *Trustee, Executors and Agency Co* case. Accordingly, because the lessee had a legal obligation under statute to pay the rates, agreeing to pay them in an agreement with the lessor could not be consideration for the supply, as the obligation already existed.

Where the rates are prepaid

23. The Commissioner considers that apportionments of prepaid rates are a part of the consideration for the vendor's supply of land.

24. A sale of land is a supply of goods for GST purposes. As a matter of contract, the vendor and purchaser can agree to any price for the land (including any apportionments). The Agreement for Sale and Purchase of Real Estate (8th edition, 2006) approved by the Real Estate Institute of New Zealand and Auckland District Law Society records the purchase price that the parties have agreed on for the property. The Agreement provides at clause 3.6 that the vendor shall prepare a "settlement statement" which is defined as follows:

> a statement showing the purchase price plus any GST payable by the purchaser in addition to the purchase price, less any deposit or other payments or allowances to be credited to the purchaser, together with apportionments of all incomings and outgoings apportioned at the possession date.

25. The settlement statement usually records the apportionment of rates that the parties have agreed on. Such an apportionment is an amount to be paid *in addition* to the purchase price recorded in the Agreement and forms part of the consideration the purchaser provides to obtain the property from the vendor.

26. Clause 3.7 of the Agreement requires that the purchaser shall pay the balance of the purchase price, interest and "other moneys" on the settlement date. The Commissioner considers that any rates apportionments recorded on the settlement statement are "other moneys".

27. The Commissioner considers that the payment of rates apportionments by the purchaser to the vendor forms part of the consideration for a single supply. Rates apportionments are paid in respect of, in response to, or for the inducement of the supply of land. An agreement to apportion rates does not create a supply to the purchaser from the vendor separate from the supply of the real property. This is because no good or service, separate from the real property, is furnished or provided to the purchaser by the vendor for that payment.

28. Although the purchaser may experience a benefit due to the vendor paying the rates for a period in which the purchaser will own the property, that benefit is not a supply. For there to be a supply, there must be a supply of something. Here the purchaser has no liability to pay rates until they are personally sent a rates assessment and/or invoice for the property. The vendor has not supplied to the purchaser a forbearance from having to pay rates, since the purchaser never had an obligation to pay those rates. Therefore, the vendor cannot make such a supply to them. Furthermore, if the purchaser receives a benefit (of not having to pay rates) that benefit is gained only because the vendor complied with their statutory obligation and not because the purchaser paid a rates apportionment. The purchaser would have received the benefit even if the purchaser did not pay the rates apportionment.

29. As the payment from the purchaser to the vendor reflecting the apportionment of prepaid rates is a payment in respect of, in response to, or for the inducement of the single supply of land, the payment increases the "consideration" and value of the supply for GST purposes. Accordingly, GST should be charged on the amount of that apportionment received by a GST-registered vendor.

30. The purchaser can claim an input tax deduction if they are entitled to an input tax deduction for the other consideration paid.

Where the rates are in arrears

The Local Government (Rating) Act 2002

31. A purchaser's liability for rates that are in arrears is a contingent liability. That is, the vendor has primary responsibility for rates invoiced during the time the vendor owns the property. Only in the event of the vendor's default would the purchaser be pursued for those rates. This is important because the existence or non-existence of a statutory obligation on the purchaser to pay an amount can affect whether payment of that amount gives rise to consideration for a supply. The continued existence of a primary liability on a vendor means the purchaser can give value to the vendor by agreeing to discharge the vendor's liability. If the liability is solely on the purchaser to meet an obligation, then no such consideration can be given to the vendor when the purchaser discharges that liability.

32. The Local Government (Rating) Act 2002 ("LGRA") states that a local authority can charge rates (sections 13–20 of the LGRA) and where rates are charged, those rates are to be paid by the ratepayer (section 12 of the LGRA). The ratepayer is the person listed in the ratings

database (section 10 of the LGRA); usually the owner or the lessee (section 11 of the LGRA).

33. When the rates are assessed, the ratepayer is given notice of their rates liability by a rates assessment: section 44 of the LGRA. If rates are due for a particular period, then the ratepayer is sent a rates invoice: section 46 of the LGRA. The rates invoice also includes a due date: section 46 of the LGRA. Both the rates assessment and the rates invoice name the ratepayer who is liable for the rates: sections 45 and 46 of the LGRA.

34. Therefore, if the vendor is the ratepayer, then the vendor will be sent the rates assessment and rates invoice and be liable for the rates. Because the vendor is named as the ratepayer and receives the rates assessment and rates invoice, the vendor remains liable for those rates until they are paid. If the vendor sells their property, they must notify the local authority of the sale within one month (section 31 of the LGRA) and the vendor will remain liable for the rates that are due while the vendor is listed as the ratepayer. Section 34 of the LGRA states:

> Notice given under sections 31 to 33 does not release any person from liability for any rates due before the notice is given.

35. However, while the vendor may be liable for rates that were charged before the sale of the property that remained unpaid when the property was sold, the new purchaser can also become responsible for the unpaid rates. A purchaser can become liable for the rates, because the rates are a charge on the land (section 59 of the LGRA) and the charge survives a sale of the property concerned.

Analysis

36. There is only one supply by the vendor where rates are in arrears, the supply of the property. The question is whether the discharge of the rates by the purchaser can be consideration for the supply of the property by the vendor.

37. Case law establishes that a taxpayer's fulfilment of a statutory obligation on them cannot amount to consideration for a supply from a supplier. However, in the context of the rating legislation the primary responsibility for discharging unpaid rates remains with the vendor, regardless of the sale of the property to the purchaser. The purchaser has only a contingent liability to pay the rates; contingent because as the rates are a charge on the land the local authority may, if unable to collect the rates from the vendor, seek payment by enforcing that charge on the land. In this sense the purchaser is able to give consideration for the supply of the property by the vendor by offering to discharge the unpaid rates as part of the bargain for the property. In such a case the purchaser is not simply fulfilling its statutory obligation, as that obligation is only contingent. Such a discharge of rates, by virtue of a contract between vendor and purchaser, can be consideration for the supply of the property.

38. Where the vendor allows a deduction from the settlement amount in return for a promise by the purchaser to discharge the unpaid local authority rates, the overall consideration received by the vendor from the purchaser is made up of three elements:
    - the purchase price;
    - the credit of the vendor's share of the unpaid rates against the purchase price; and
    - the total amount of the vendor's liability to the local authority that the purchaser has agreed to discharge.

39. That is, the consideration for the vendor's supply is made up of the actual monetary consideration received by the vendor from the purchaser and the discharge of the vendor's liability to the local authority.

40. The amount of the vendor's liability to the local authority that the purchaser has agreed to discharge, less the credit of the vendor's share of the unpaid rates against the purchase price will generally equal the purchaser's share of the unpaid rates. This means that the consideration remains the same as in a "prepaid rates" situation, being equal to the purchase price plus the purchaser's share of the rates. The difference between the "prepaid rates" and "rates in arrears" situations is that where rates are prepaid, the consideration is the total amount paid by the purchaser to the vendor; whereas where rates are in arrears, the consideration is the total amount paid by the purchaser to the vendor and to the local authority.

41. This is consistent with the definition of "consideration" in section 2(1). That definition includes any payment made "in respect of, in response to, or for the inducement of" the supply of any goods and services, but does not require the payment to be made to the supplier.

Section 5(15) of the GST Act

42. If the property being transferred is to be used by the purchaser in a taxable activity and the property also includes a dwelling (for example, farm land that includes a house), section 5(15) deems the dwelling (not being a commercial dwelling) to be a separate supply from the supply of the land. The effect of this is that GST is charged only on the commercial supply (that is, the farm land) and not on the residential supply (that is, the house). The rates apportionment, since it forms part of the consideration for the

property, will be divided between the dwelling and the land. One possible method for dividing the rates apportionment between the dwelling and the land is given in Example 7 in paragraphs 95 to 106.

Examples

43. This part of the commentary discusses seven different land sale examples and sets out the GST consequences of each scenario. Examples 1–3 are situations where the rates are prepaid, so they explain the application of BR Pub 10/10 and BR Pub 10/11. Examples 4–6 are situations where the rates are in arrears, so they explain the application of BR Pub 10/12 and BR Pub 10/13. Example 7 is a situation where section 5(15) applies.

44. Each example discusses the GST consequences of the transaction, shows a sample settlement statement, and, if applicable, shows a sample tax invoice. The sample settlement statements and tax invoices are not prescriptive; they are examples of how these documents might be drafted.

45. The situations in the examples involve property transactions where settlement takes place in April 2010. Because of this the GST rate used in the calculations is 12.5 percent. For transactions where the time of supply is on or after 1 October 2010 the applicable GST rate will be 15 percent. The same approach can be taken towards these transactions as is taken in the examples, with the only difference being the different GST rate.

Situations where rates are prepaid

Assumptions underpinning Examples 1–3

46. The GST position for rates paid in advance is illustrated in the property sale examples that follow. In Examples 1–3 assume the following:
    - The vendor is selling property to the purchaser.
    - The purchase price the parties have agreed is $400,000 (plus GST, if any). The purchaser has paid a deposit of $40,000.
    - The settlement date is 26 April 2010.
    - The vendor has paid the local authority rates in advance to 30 June 2010.
    - The annual rating liability to the local authority is $2,463.75 (inclusive of $273.75 of GST).
    - The amount of rates relating to the period of the purchaser's occupation of the land is $438.75 (inclusive of $48.75 of GST). This amount is payable by the purchaser to the vendor under the agreement for sale and purchase of the land.

Example 1: Sale by an unregistered vendor

47. An unregistered vendor is not entitled to an input tax deduction for the rates it has paid in advance to the local authority. The supply of the property will not be a taxable supply for GST purposes.

48. In the absence of a provision in the Property Law Act 2007 or elsewhere, the amount of the apportionment is a matter for negotiation between the vendor and purchaser. Usually, however, the vendor would wish to recover the full GST inclusive amount of $438.75.

49. The total consideration paid by the purchaser and received by the vendor would be $400,438.75.

50. If the purchaser is unregistered, the Act does not allow an input tax deduction.

51. If the purchaser is registered and entitled to a secondhand goods deduction on the overall property purchase, then the purchaser is able to claim an input tax deduction for the rates apportionment under section 20(3).

52. The vendor's settlement statement would be:

Purchaser:		
Vendor:		
Settlement Date: 26 April 2010		
ADDRESS OF PROPERTY		
TO: Purchase price in accordance with contract	400,000.00	
BY: Deposit paid		40,000.00
TO: Purchaser's proportion of rates from 27/4/10 to 30/6/10 (65 days at $2,463.75 p/a)	438.75	
BY: Balance required to settle		360,438.75
	$400,438.75	**$400,438.75**
Amount required to settle on 26 April 2010	**$360,438.75**	

53. The vendor is unregistered, so a GST tax invoice is not required.

Example 2: Sale by a registered vendor – standard rate

54. If the vendor can satisfy the requirements of section 20(3) the vendor will be able to claim an input tax deduction for the GST on the amount of annual rates it has prepaid to the local authority.

55. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity, so it is a taxable supply on which the vendor must charge and return GST output tax.

The apportionment of the rates paid will be part of the consideration for that supply. This part of the consideration will be $390, plus $48.75 of output tax, which the vendor must return to Inland Revenue. The total consideration for the supply will be $450,438.75.

56. If the purchaser is unregistered, the Act does not allow an input tax deduction.

57. If the purchaser is registered and can satisfy the requirements of section 20(3), the purchaser can claim an input tax deduction for the GST element of the purchase price and the rates apportionment.

58. The vendor would return GST output tax on the value of the supply of land (including the apportionments) and would issue a tax invoice to the purchaser inclusive of the apportionments.

59. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2010

ADDRESS OF PROPERTY

TO: Purchase price in accordance with contract	400,000.00	
TO: GST as per tax invoice	50,048.75	
BY: Deposit paid		40,000.00
TO: Purchaser's proportion of rates from 27/4/10 to 30/6/10 (65 days at $2,190 p/a GST exclusive)	390.00	
BY: Balance required to settle		410,438.75
	$450,438.75	**$450,438.75**
Amount required to settle on 26 April 2010	**$410,438.75**	

60. The vendor's tax invoice would be:

TAX INVOICE

23 April 2010

From: Vendor's name GST number: XXX-XXX-XXX
Vendor's address

To: Purchaser's name
Purchaser's address

ADDRESS OF PROPERTY

TO: Purchase price as per agreement	$400,000.00
TO: Purchaser's share of rates apportioned as at settlement date	$390.00
TO: GST on total value of supply	$50,048.75
	$450,438.75

Total GST: **$50,048.75**
Settlement date – 26 April 2010

61. The Taxation (GST and Remedial Matters) Bill 2010 was tabled in Parliament on 5 August 2010. If enacted in its current form, this Bill would require supplies made on or after 1 April 2011 that are between registered persons and that wholly or partly consist of land to be zero-rated.

Example 3: Sale by a registered vendor – zero rated

62. A zero-rated sale by a registered vendor arises when the supply is of land that was a taxable activity, or part of a taxable activity, as a going concern within section 11(1)(m).

63. The Taxation (GST and Remedial Matters) Bill 2010 was tabled in Parliament on 5 August 2010. If enacted in its current form, this Bill would require supplies made on or after 1 April 2011 that are between registered persons and that wholly or partly consist of land to be zero-rated.

64. If the vendor can satisfy the requirements of section 20(3) the vendor will be able to claim an input tax deduction for the GST on the amount of annual rates it has prepaid to the local authority.

65. In this situation the apportionments on sale should be GST exclusive ($390) rather than inclusive ($438.75), which is consistent with zero-rating the supply of the going concern.

66. The total consideration paid by the purchaser and received by the vendor would be $400,390.

67. As the sale is zero-rated, the purchaser cannot claim an input tax deduction for any element of the consideration for the property, including the rates apportionment.

68. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2010

ADDRESS OF PROPERTY

TO: Purchase price in accordance with contract	400,000.00	
TO: GST as per tax invoice	nil	
BY: Deposit paid		40,000.00
TO: Purchaser's proportion of rates from 27/4/10 to 30/6/10 (65 days at $2,190 p/a GST exclusive)	390.00	
BY: Balance required to settle		360,390.00
	$400,390.00	**$400,390.00**
Amount required to settle on 26 April 2010	**$360,390.00**	

BINDING RULINGS

69. The vendor's tax invoice would be:

TAX INVOICE	
23 April 2010	
From: Vendor's name GST number: XXX-XXX-XXX Vendor's address	
To: Purchaser's name Purchaser's address	
ADDRESS OF PROPERTY	
TO: Purchase price as per agreement	$400,000.00
TO: Purchaser's share of rates apportioned as at settlement date	$390.00
TO: GST – zero rated	nil
	$400,390.00
Settlement date – 26 April 2010	
Both the vendor and the purchaser agree that this is a sale of a going concern under the Goods and Services Tax Act 1985 and is therefore zero-rated	

Situations where the rates are in arrears

Assumptions underpinning Examples 4–6

70. The GST position for rates in arrears is illustrated in the land sale examples that follow. In Examples 4–6 assume the following:

- The vendor is selling property to the purchaser.
- The purchase price the parties agreed is $400,000 (plus GST, if any). The purchaser has paid a deposit of $40,000.
- The settlement date is 26 April 2010.
- The vendor has not paid the local authority rates from 1 April 2010 (that is, the rates are in arrears for the current rating quarter).
- The annual rating liability to the local authority is $2,463.75 (inclusive of $273.75 of GST).
- The amount outstanding for the current quarter is $614.25 (inclusive of $68.25 of GST). Of this figure, the amount of rates relating to the period of the vendor's occupation of the land is $175.50 (inclusive of $19.50 of GST).
- The parties have agreed that the purchaser will discharge the unpaid rates, in exchange for a deduction from the settlement amount for the amount of rates relating to the period of the vendor's occupation of the land.

Example 4: Sale by an unregistered vendor

71. In a sale by an unregistered vendor, the supply of the property will not be a taxable supply for GST purposes.

72. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example the parties have agreed to a credit of the GST inclusive amount of the vendor's share of the rates: $175.50. This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

73. As discussed at paragraph 38 above, the consideration is made up of three elements. These elements are:

- the purchase price: $400,000;
- the credit of the vendor's share of the unpaid rates against the purchase price: $175.50; and
- the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $614.25.

74. Therefore, the total consideration for the supply will be $400,438.75.

75. If the purchaser is unregistered, the Act does not allow an input tax deduction for any element of the transaction.

76. If the purchaser is registered and can satisfy the requirements of section 20(3), the purchaser is able to claim a secondhand goods deduction for the property purchase. The consideration will be $400,438.75, so this is the figure the purchaser should use for calculating the amount of input tax.

77. The vendor is unregistered, so a GST tax invoice is not required. The vendor's settlement statement would be:

Purchaser:		
Vendor:		
Settlement Date: 26 April 2010		
ADDRESS OF PROPERTY		
TO: Purchase price in accordance with contract	400,000.00	
TO: Rates to be paid by purchaser as agreed by parties	614.25	
BY: Deposit paid		40,000.00
BY: Credit for vendor's proportion of unpaid rates from 1/4/10 to 26/4/10 (26 days at $2,463.75 p/a)		175.00
BY: Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		614.25
BY: Balance required to settle		359,824.50
	$400,614.25	**$400,614.25**
Amount required to settle on 26 April 2010	**$359,824.50**	

Example 5: Sale by a registered vendor – standard rate

78. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity and is therefore a taxable supply on which the vendor must charge and return GST output tax.

79. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example the parties have agreed to a credit against the GST exclusive purchase price of the GST exclusive amount of the vendor's share of the rates: $156. (This gives the same result as a credit of the GST inclusive amount of the vendor's share of the rates ($175.50) against the GST inclusive purchase price.) This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

80. As discussed at paragraph 38 above, the consideration is made up of three elements. These elements are:

- the purchase price: $400,000 plus GST, so $450,000;
- the credit of the vendor's share of the unpaid rates against the purchase price: $175.50; and
- the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $614.25.

81. Therefore, the total consideration for the supply will be $450,438.75. As consideration is a GST-inclusive amount, the correct amount of GST on the supply is the tax fraction of the consideration – $50,048.75. The vendor must charge and return this amount.

82. If the purchaser is unregistered, the Act does not allow an input tax deduction.

83. If the purchaser is registered and can satisfy the requirements of section 20(3), the purchaser is able to claim an input tax deduction for the purchase of the property.

84. The vendor's settlement statement would be:

Purchaser:		
Vendor:		
Settlement Date: 26 April 2010		
ADDRESS OF PROPERTY		
TO: Purchase price in accordance with contract	400,000.00	
TO: Rates to be paid by purchaser as agreed by parties (GST exclusive)	546.00	
TO: GST as per tax invoice	50,048.75	
BY: Deposit paid		40,000.00
BY: Credit for vendor's proportion of unpaid rates from 1/4/10 to 26/4/10 (26 days at $2,190 p/a GST exclusive)		156.00
BY: Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		614.25
BY: Balance required to settle		409,824.50
	$450,594.75	**$450,594.75**
Amount required to settle on 26 April 2010	**$409,824.50**	

BINDING RULINGS

85. The vendor's tax invoice would be:

TAX INVOICE	
23 April 2010	
From: Vendor's name GST number: XXX-XXX-XXX	
Vendor's address	
To: Purchaser's name	
Purchaser's address	
ADDRESS OF PROPERTY	
TO: Purchase price as per agreement	$399,844.00
TO: Rates to be paid by purchaser to local authority	$546.00
TO: GST on total value of supply	$50,048.75
	$450,438.75
Total GST: **$50,048.75**	
Settlement date – 26 April 2010	

86. The Taxation (GST and Remedial Matters) Bill 2010 was tabled in Parliament on 5 August 2010. If enacted in its current form, this Bill would require supplies made on or after 1 April 2011 that are between registered persons and that wholly or partly consist of land to be zero-rated.

Example 6: Sale by a registered vendor – zero rated

87. A zero-rated sale by a registered vendor arises when the supply is of land that was a taxable activity, or part of a taxable activity, as a going concern within section 11(1)(m).

88. The Taxation (GST and Remedial Matters) Bill 2010 was tabled in Parliament on 5 August 2010. If enacted in its current form, this Bill would require supplies made on or after 1 April 2011 that are between registered persons and that wholly or partly consist of land to be zero-rated.

89. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example the parties have agreed to a credit of the GST inclusive amount of the vendor's share of the rates ($175.50) **plus** the amount of GST input tax credit that the vendor has claimed on the purchaser's share of the rates ($48.75): $224.25. This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position as they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

90. As discussed at paragraph 38 above, the consideration is made up of three elements. These elements are:
- the purchase price: $400,000;
- the credit of the vendor's share of the unpaid rates **and** the GST on the purchaser's share of the rates against the purchase price: $224.25; and
- the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $614.25.

91. Therefore, the total consideration for the supply will be $400,390.

92. As the sale is zero-rated, the purchaser cannot claim an input tax deduction for any element of the consideration for the property, including the rates apportionment.

93. The vendor's settlement statement would be:

Purchaser:		
Vendor:		
Settlement Date: 26 April 2010		
ADDRESS OF PROPERTY		
TO: Purchase price in accordance with contract	400,000.00	
TO: Rates to be paid by purchaser as agreed by parties	614.25	
TO: GST as per tax invoice	nil	
BY: Deposit paid		40,000.00
BY: Credit for vendor's proportion of unpaid rates from 1/4/10 to 26/4/10 (26 days at $2,463.75 p/a GST inclusive)		175.50
BY: Credit for GST claimed by vendor on purchaser's share of rates		48.75
BY: Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		614.25
BY: Balance required to settle		359,775.75
	$400,614.25	**$400,614.25**
Amount required to settle on 26 April 2010	**$359,775.75**	

94. The vendor's tax invoice would be:

TAX INVOICE

25 April 2010

From: Vendor's name GST number: XXX-XXX-XXX
Vendor's address

To: Purchaser's name
Purchaser's address

ADDRESS OF PROPERTY

TO: Purchase price as per agreement, less discount for unpaid rates	$399,775.75
TO: Rates to be paid by purchaser to local authority	$614.25
TO: GST on total value of supply	nil
	$400,390.00

Settlement date – 26 April 2010

Both the vendor and the purchaser agree that this is a sale of a going concern under the Goods and Services Tax Act 1985 and is therefore zero-rated

Situations where section 5(15) applies

95. For example 7, assume the following:

- The vendor is selling property to the purchaser.
- The land in question is farm land that includes a farm house.
- The purchase price agreed on by the parties is $2,500,000 (plus GST). The purchaser has paid a deposit of $250,000.
- The value of the farm house and curtilage is $500,000.
- The settlement date is 26 April 2010.
- The vendor has paid the local authority rates in advance to 30 June 2010.
- The annual rating liability to the local authority is $7,300 (exclusive of $912.50 of GST). The amount of rates relating to the period of the purchaser's occupation of the land is $1,300 (exclusive of $162.50 of GST). This amount is payable by the purchaser to the vendor under the agreement for sale and purchase of the land.

Example 7: Sale by a registered vendor – sale of commercial land with a dwelling

96. If the vendor can satisfy the requirements of section 20(3), the vendor can claim an input tax deduction for the GST component of the rates it has prepaid to the local authority. This input tax deduction will be subject to an adjustment for private use.

97. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity and is therefore a taxable supply on which the vendor must charge and return GST output tax. The vendor must charge and return GST on the value of the land (the taxable supply), but not on the value of the dwelling and curtilage (the non-taxable supply).

98. The rates apportionment will be part of the consideration for the supply. The amount of the apportionment is a matter for negotiation between the vendor and purchaser. In this example the parties have agreed that the apportionment will be $1,300, plus output tax that the vendor must return to Inland Revenue. The amount of the output tax will depend on the amount of the rates apportionment that is allocated to the land and the amount that is allocated to the dwelling and curtilage. This amount may be able to be calculated by reference to the local authority rates demand.

99. In this example the local authority rates demand shows that 24 percent of the rates amount is directly attributable to the taxable supply (that is, relates to services provided in relation to the farm land), 16 percent is directly attributable to the non-taxable supply (that is, relates to services provided in relation to the farm house and curtilage), and the remaining 60 percent is attributable to both the taxable and the non-taxable supply.

100. The sample tax invoice below shows how the rates apportionment may be divided based on these figures. In this example GST is charged on the entire amount directly attributable to the taxable supply ($312 equals 24 percent of $1,300) and on 80 percent of the amount attributable to both the taxable and the non-taxable supply ($780 equals 60 percent of $1,300, 80 percent of this amount is $624). The reason for charging GST on 80 percent of the rates attributable to both the taxable and non-taxable supply is that the taxable supply (the farm land) makes up 80 percent of the total supply.

101. The total consideration for the supply will be $2,751,417.

102. If the purchaser is unregistered, the Act does not allow an input tax deduction.

103. If the purchaser is registered and can satisfy the requirements of section 20(3), the purchaser is able to claim an input tax deduction for the GST element of the purchase price and the rates apportionment.

104. The vendor's settlement statement would be:

Purchaser:

Vendor:

Settlement Date: 26 April 2010

ADDRESS OF PROPERTY

TO: Purchase price in accordance with contract	2,500,000.00	
TO: GST as per tax invoice	250,117.00	
BY: Deposit paid		250,000.00
TO: Purchaser's proportion of rates from 27/4/10 to 30/6/10 (65 days at $7,300 p/a GST exclusive)	1,300.00	
BY: Balance required to settle		2,501,417.00
	$2,751,417.00	**$2,751,417.00**
Amount required to settle on 26 April 2010	**$2,501,417.00**	

105. The vendor's tax invoice would be:

TAX INVOICE

23 April 2010

From: Vendor's name GST number: XXX-XXX-XXX
Vendor's address

To: Purchaser's name
Purchaser's address

ADDRESS OF PROPERTY

TO: Purchase price as per agreement		$2,500,000.00
Supply subject to GST		
Purchase price as per agreement	$2,500,000.00	
LESS non-taxable supplies	$500,000.00	
Taxable supply	$2,000,000.00	
TO: GST on taxable supply		$250,000.00
TO: Purchaser's share of rates apportioned as at settlement date		$1,300.00
Rates attributable to the taxable supply:		
Rates attributable to both the taxable and non-taxable supplies	$780.00	
Taxable supply as a percentage of the total supply (see "supply subject to GST" above)	80%	
80% of $780.00	$624.00	
PLUS Rates directly attributable to the taxable supply	$312.00	
	$936.00	
TO: GST on rates apportionment attributable to the taxable supply		$117.00
		$2,751,417.00

Total GST: **$250,117.00**

Settlement date – 26 April 2010

106. The Taxation (GST and Remedial Matters) Bill 2010 was tabled in Parliament on 5 August 2010. If enacted in its current form, this Bill would require supplies made on or after 1 April 2011 that are between registered persons and that wholly or partly consist of land to be zero-rated.

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

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

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

BACKGROUND TO INTERPRETATION STATEMENT IS 10/07

This Interpretation Statement is the successor of two exposure drafts:

- INS0072: Interpretation of Sections 6 and 6A of the Tax Administration Act 1994, Care and Management of Taxes (December 2005)
- INS0072: Care and management of the taxes covered by the Inland Revenue Acts – Section 6A(2) and (3) of the Tax Administration Act 1994 (August 2008).

Both exposure drafts were released for consultation. After taking account of the submissions and further consideration, the second exposure draft has been revised and is published as this Statement.

The principles and conclusions contained in this Statement are essentially the same as those contained in the second exposure draft. The following are the significant differences between the Statement and the second exposure draft:

- The Statement more extensively discusses the relationship between section 6A and the other provisions of the Inland Revenue Acts and, in particular, what the Commissioner can and cannot do under section 6A.
- The Statement contains new paragraphs discussing the three factors in section 6A(3), and clarifies the weight each factor is to be given.
- The Statement's discussion on settlements and agreements states the Commissioner's position on settlements in multi-party tax disputes, and notes the effect of the Protocol between the Commissioner and the Solicitor General.
- The answers given to several examples in the Statement have been extensively revised and, in some cases, a different conclusion reached. This was done so as to identify more clearly the weight that the Commissioner would give particular factors on the facts, and to specifically address matters raised in the submissions. The examples have also been reordered and given new headings. As was proposed in the second exposure draft, two examples have been deleted. A new example 6 has been inserted to deal with the relationship between section 6A and the Commissioner's binding rulings function.

IS 10/07: CARE AND MANAGEMENT OF THE TAXES COVERED BY THE INLAND REVENUE ACTS – SECTION 6A(2) AND (3) OF THE TAX ADMINISTRATION ACT 1994

All references are to the Tax Administration Act 1994 unless otherwise stated.

Introduction

1. A reality of modern tax administration is that the Commissioner must operate the tax system with limited resources. This means that the Commissioner cannot always collect every last dollar of tax owing in every case. As a result, the Commissioner must decide how to best use his resources to maximise the taxes collected and to foster the integrity and effective functioning of the tax system. The Commissioner's resource allocation and management decisions can affect the integrity of the tax system, including taxpayer perceptions of that integrity. In particular, what may be seen by one taxpayer as flexibility that achieves a practical and sensible outcome could be seen as inconsistency or favouritism by other taxpayers.
2. Before section 6A(2) and (3) were enacted, the Inland Revenue Acts arguably obligated the Commissioner to collect all taxes owing, regardless of the costs

and resources involved. According to this view, the Commissioner could decide not to collect taxes owing only if a specific statutory discretion or power authorised him to do so. The possibility that the Commissioner was required to collect all taxes owing (subject only to the specific relief and remission provisions) was problematic, because it:

- was an unrealistic obligation given the Commissioner's limited resources; and
- sat uncomfortably with the appropriation and financial accountability requirements under the Public Finance Act 1989 and State Sector Act 1988.

3. As a result, section 6A(2) and (3) were enacted to make clear that the Commissioner is not required to collect all taxes owing. Section 6A(2) provides that the Commissioner is "charged with the care and management of the taxes covered by the Inland Revenue Acts". Section 6A(3) provides that the Commissioner has the duty to "collect over time the highest net revenue that is practicable within the law". Section 6A(2) and (3) legislatively recognise that the Commissioner exercises managerial discretion as to the allocation and management of his resources.
4. Section 6 was enacted at the same time as section 6A(2) and (3). Section 6 requires the Commissioner, at all times, to use best endeavours to protect the integrity of the tax system. Section 6A(2) and (3), along with section 6, provide guidance on the exercise of the managerial discretion and ensure the integrity of the tax system is protected.
5. This Interpretation Statement sets out the Commissioner's view on his "care and management" responsibility in section 6A(2) and his duty in section 6A(3). In the course of doing so, it clarifies the relationship between section 6A (2) and (3) and the other provisions of the Inland Revenue Acts, including section 6. Factual examples illustrate the principles set out in this Statement: see paragraphs 172–237 below.

Summary

6. The following paragraphs summarise the principles set out in this Statement on:
   - the "care and management" responsibility under section 6A(2);
   - the specific duty under section 6A(3); and
   - the relationship between section 6A(2) and (3) and section 6.

Section 6A(2)

7. Section 6A(2) provides that the Commissioner is "charged with the care and management of the taxes covered by the Inland Revenue Acts". In doing so, section 6A(2) imposes two interrelated responsibilities on the Commissioner.
8. First, the Commissioner is charged with the "care" of the taxes. This means the Commissioner is responsible for promoting the integrity and effective functioning of the tax system. To discharge this responsibility, the Commissioner must seek to foster the tax system's capacity to function effectively in light of economic, commercial, technological and other changes.
9. Second, the Commissioner is charged with the "management" of the taxes. This means he is responsible for making managerial decisions in the interests of bringing about the efficient and effective administration of the tax system. The "management" responsibility recognises that the Commissioner makes decisions about the allocation and management of his limited resources. This involves the Commissioner exercising judgement as to the resources he allocates, over time, across the various parts of Inland Revenue and to dealing with particular taxpayers. The "management" responsibility also recognises that the Commissioner often exercises judgement as to how he carries out his functions.
10. Section 6A(2) and (3) were enacted together (along with section 6) to provide the framework within which the Commissioner administers the tax system. Section 6A(3) applies "[i]n collecting the taxes committed to the Commissioner's charge". The collecting of taxes is an aspect of the Commissioner's "management" responsibility. Section 6A(3) clarifies the Commissioner's overall objective in carrying out his functions in administering the tax system.
11. Section 6A(2) and (3) make clear that the Commissioner is not required to collect all taxes owing regardless of the costs and resources involved. Instead the Commissioner has the duty to maximise the net revenue collected over time. Accordingly, section 6A(2) and (3) may authorise the Commissioner to act inconsistently with the rest of the Inland Revenue Acts only to the extent that they otherwise require him to collect the full amount of tax. Section 6A(2) and (3) do not allow the Commissioner to act inconsistently with any other legislative and constitutional constraints and obligations. Some important implications of this are that the Commissioner cannot:

- disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- alter taxpayers' obligations and entitlements;
- issue extra-statutory concessions;
- administratively remedy legislative errors and other deficiencies;
- interpret provisions other than in accordance with statutory interpretation principles contained in the Interpretation Act 1999 and court decisions; or
- act inconsistently with his obligation under section 6 to use best endeavours to protect the integrity of the tax system.

12. As with the Commissioner's other powers and discretions, it is for the Commissioner to prescribe which officers have the delegated authority to make decisions pursuant to section 6A(2) and (3). In addition, the Commissioner may, from time-to-time, issue guidelines that set out how Inland Revenue officers are to act under section 6A(2) and (3).

Section 6A(3)

13. Section 6A(3) imposes on the Commissioner the duty to "collect over time the highest net revenue that is practicable within the law".

14. The Commissioner must discharge the section 6A(3) duty when "collecting the taxes committed to the Commissioner's charge". The word "collecting" could be interpreted narrowly to mean that section 6A(3) only applies after the taxes have been assessed and when the Commissioner seeks to recover those taxes. However, the Commissioner interprets the word "collecting" more broadly. The word refers to the actions the Commissioner takes, before and after the taxes have been assessed, to carry out his functions in administering the tax system.

15. Section 6A(3) requires the Commissioner to maximise the net revenue he collects "over time". The words "over time" require the Commissioner to balance the short and long term implications of the available means of administering the tax system or dealing with particular taxpayers. These words mean that the Commissioner may adopt courses of action that have the effect of forgoing the collection of the highest net revenue:
    - in the short term, if he considers that this will enable the collection of more net revenue in the longer term; and
    - from particular taxpayers, if he considers that this will enable more net revenue to be collected from all taxpayers.

16. In addition, section 6A(3) requires the Commissioner to have regard to three factors when deciding on which course of action to take. These factors are:
    - the resources available to the Commissioner;
    - the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
    - the compliance costs incurred by the taxpayers.

    Section 6A(3) does not prescribe the weight to be given to each factor. The weight to be given each factor depends on the circumstances of the particular case.

17. The words "within the law" and "notwithstanding anything in the Inland Revenue Acts" affect what courses of action the Commissioner can undertake to "collect over time the highest net revenue that is practicable". The words "notwithstanding anything in the Inland Revenue Acts" mean that the Commissioner can carry out the course of action that he considers will "collect over time the highest net revenue that is practicable" even if it results in less tax being collected than is imposed, or required to be collected, by another provision. The words "within the law" mean that the Commissioner must act consistently with the other provisions of the Inland Revenue Acts.

18. Section 6A(3) is not overridden by a later enacted provision unless Parliament specifically intended the later provision to do so.

Section 6

19. Section 6(1) requires the Commissioner, at all times, to use best endeavours to protect the "integrity of the tax system". Section 6 applies to all of the Commissioner's functions in administering the tax system. The term "integrity of the tax system" is defined non-exhaustively in section 6(2).

20. Section 6 is not inconsistent with section 6A(2) and (3), because it does not require the Commissioner to collect all taxes regardless of the costs and resources involved. Therefore the Commissioner must comply with section 6 when acting under section 6A(2) and (3). This means that when deciding how he will act under section 6A(2) and (3), the Commissioner must consider, and take into account, the extent to which the available courses of action might undermine, or support, the integrity of the tax system.

Legislation

21. Sections 6 and 6A provide:

> **6 Responsibility on Ministers and officials to protect integrity of tax system**
>
> (1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.
>
> (2) Without limiting its meaning, **the integrity of the tax system** includes—
>
> (a) taxpayer perceptions of that integrity; and
>
> (b) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; and
>
> (c) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and
>
> (d) the responsibilities of taxpayers to comply with the law; and
>
> (e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and
>
> (f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.
>
> **6A Commissioner of Inland Revenue**
>
> (1) The person appointed as chief executive of the Department under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.
>
> (2) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.
>
> (3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—
>
> (a) the resources available to the Commissioner; and
>
> (b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
>
> (c) the compliance costs incurred by taxpayers.

Legislative history

22. By way of background, the legislative history of section 6A and section 6 will be outlined. This includes discussing two reports that lead to the enactment of section 6A and section 6:

- *First Report of the Working Party on the Re-organisation of the Income Tax Act 1976*, July 1993, Wellington ("the Valabh report"); and
- *Organisational Review of the Inland Revenue Department*, Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance), April 1994, Wellington ("the ORC report").

The courts have treated these reports as relevant legislative history when considering section 6A and section 6: *Westpac Banking Corp v CIR* [2008] NZSC 24 (SC); *Auckland Gas Co Ltd v CIR* (1999) 19 NZTC 15,027 (CA); *Fairbrother v CIR* (2000) 19 NZTC 15,548 (HC); *Accent Management Ltd (No 2) v CIR* (2007) 23 NZTC 21,366 (CA). Paragraphs 35–41 below also note the origins of section 6A in the United Kingdom legislation and case law.

Valabh report (1993)

23. In June 1993 the Valabh Committee was asked to (Valabh report, page 1):

> Report to the Minister of Revenue on the appropriate statutory independence of the position of the Commissioner of Inland Revenue and its relationship with the role of the Minister in specifying priorities in, and the nature of, tax administration and enforcement given the Commissioner's accountabilities and responsibilities under the Public Finance Act and the State Sector Act.

24. In its report, the Valabh Committee noted that the Income Tax Act imposed the obligation to pay income tax, and that the Commissioner's statutory functions were directed to the quantification of that liability. It considered that in its "extreme form" the law obliged the Commissioner to "assess and recover all taxes which are due" (Valabh report, page 6). The Committee considered this was an unrealistic obligation that did not match the practice of the Department. Moreover, any such obligation sat uncomfortably with the appropriation and financial accountability requirements of the State Sector Act 1988 and the Public Finance Act 1989. These required departments to focus on the "efficient, effective and economic production of their outputs, the funding for which is appropriated by Parliament" (Valabh report, page 14). The Commissioner was required to act consistently with both enactments.

25. Consequently the Valabh Committee recommended that there should be "legislative recognition of managerial discretion to determine priorities and enter into sensible settlements". It considered that the United Kingdom care and management provision provided "a useful model". This recommendation was accompanied by a note of caution (Valabh report, page 8):

> Such a change in the legislation would have to be presented and implemented with due care. It would be important to emphasise for instance that the taxes are committed to the Commissioner's charge. Taxpayers may try to take advantage of an apparently increased discretion, and there could be some prospect of greater variability in decisions. Taxpayers are above all entitled to decisions which are correct and consistent. As well, there is always scope for abuse in the administration of the tax system. … It is important that the professionalism and impartiality of those charged with administering the tax system is not called into question. This could happen if the discretion were extended beyond the limited scope suggested by the Working Party and if the administrative arrangements do not involve adequate guidelines and other safeguards.

26. After the publication of the Valabh report, members of the Court of Appeal in *Brierley Investments Ltd v CIR* (1993) 15 NZTC 10,212 (CA) differed as to whether the Commissioner had "care and management" responsibilities similar to those imposed by the United Kingdom legislation.

27. In *Brierley Investments*, Richardson J considered that under the tax legislation at that time the Commissioner was obliged to assess and collect all taxes. His Honour held that the income tax legislation proceeded on the "premise" that it was in the interests of the community that the Commissioner ensured that the income of every taxpayer is assessed and the tax paid. The Commissioner could not contract out of those obligations (at page 10,217):

> Certainly there is nothing in the New Zealand legislation to justify the conclusion that the Commissioner may elect not to assess taxpayers or may elect to charge them with less tax than throughout the assessment and re-assessment period the Commissioner considers due.

28. Richardson J held that this "premise" of the New Zealand legislation meant that, unlike under the United Kingdom legislation, there was "no scope for weighing and balancing management functions against collection responsibilities in respect of particular taxpayers" (at page 10,219). His Honour recognised that in reality limited resources would affect "the nature and the extent of the investigation undertaken to quantify the statutorily imposed liability for tax and the efforts made to pursue recovery" (at page 10,215).

29. Casey J took the opposite view to Richardson J. Casey J considered that the United Kingdom "care and management" jurisprudence was relevant to New Zealand. This was because his Honour could (at page 10,225):

> … see no essential distinction between [the Commissioner's] obligations and those of the United Kingdom Commissioners who are charged with the "care management and collection" of tax. Administering revenue acts must require similar duties and administrative discretions in each country in the assessment and collection of tax, calling for the exercise of similar standards of fairness.

Casey J accepted that the Commissioner did not have any "dispensing power", and that it could not be an abuse of power for the Commissioner to collect taxes due. His Honour considered, however, that the duty to collect taxes could not be isolated from the Commissioner's functions of administering and managing the tax system.

Organisational Review Committee report (1994)

30. In light of the recommendations of the Valabh Committee, the Organisational Review Committee (chaired by Sir Ivor Richardson) was set up to investigate the optimal organisational arrangements for the tax system. In its 1994 report, the Organisational Review Committee reviewed and made recommendations about the tax administration structure.

31. Relevant to this Statement is the Organisational Review Committee's observations on the Commissioner's obligation to collect taxes. The Committee stated (ORC report, sections 7.2.2 and 8.2):

> **IRD's legislative objective is not achievable (refer Section 8, Objective of tax administration)**
>
> An interpretation of the legislation is that IRD is required by the Inland Revenue Department Act to 'administer' the Act and, amongst other things, to collect 'all' the tax. For many practical reasons, this objective is impossible to achieve. But there is a clear general expectation that IRD will collect the most revenue that it can within certain limitations. Other factors affecting the ability to meet requirements under [the] legislation are also relevant such as the exercise of good management, and the need for trade-offs between factors such as compliance costs and information requirements.
>
> …
>
> The Review Committee agrees with the view of the Valabh Committee that this is not a realistic objective. Clearly, the Commissioner, like other chief executives, is subject to resource constraints imposed by Parliament. So the Commissioner cannot be expected to collect all taxes. The objective of the tax administration function of IRD therefore should be changed to match these current needs and situation.

32. The Committee agreed with the Valabh Committee's recommendation that there should be legislative recognition of the Commissioner's managerial discretion (ORC report, section 9.4.2):

    It is not possible for the Chief Executive of IRD, operating within limited resources, to ensure that every cent of due taxes is collected. Explicit recognition of the management of limited resources in the efficient and effective collection of taxes is required.

33. The Committee considered that the Commissioner's responsibility for the "management of limited resources in the efficient and effective collection of taxes" was encapsulated by the term "care and management". It defined this term as (ORC report, Glossary and Commonly Used Abbreviations, page 81):

    Managerial discretion as to the use of independent statutory powers in a cost effective manner.

    The Committee recognised that the Inland Revenue Department Act 1974 (now repealed) would need to be amended to recognise any "care and management" responsibility. It considered that it was uncertain whether section 4 of the 1974 Act, which provided that the Commissioner was charged with the "administration" of the Inland Revenue Acts, "implies that care and management of limited resources overrides the more specific tasks and duties of the Commissioner defined in the Inland Revenue Acts" (ORC report, Appendix D, pages 24–25).

34. Consequently, the Committee recommended its draft section 4 of the Inland Revenue Act 1976 be enacted. It considered that draft section 4 recognised the Commissioner's managerial discretion and, at the same time, subjected this discretion to safeguards and guidance. The relevant parts of the draft section 4 were:

    (1) Every Minister and Officer of any Department having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts will at all times use their best endeavours to protect the integrity of the tax system.

    (2) Without limiting the meaning of "the integrity of the tax system" it reflects:

    (i) taxpayer perceptions of that integrity;

    (ii) the rights of taxpayers to have their liability determined fairly, impartially and according to law;

    (iii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers;

    (iv) the responsibilities of taxpayers to comply with the law;

    (v) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and

    (vi) the responsibilities of those administering the law to do so fairly, impartially and according to law.

    …

    (4) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

    (5) In collecting the taxes committed to the Commissioner's charge and notwithstanding anything in the Inland Revenue Acts the Commissioner will collect over time the highest net revenue that is practicable within the law having regard to:

    (i) the resources available to the Commissioner;

    (ii) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and

    (iii) the compliance costs incurred by taxpayers.

    …

    (9) For the purposes of this section "tax" includes any revenue or entitlements covered by the Inland Revenue Acts and "taxpayers" and "taxes" shall be construed accordingly.

These parts of the draft section 4 are almost identical to section 6 and section 6A(2) and (3).

United Kingdom legislation and case law

35. Both the Valabh Committee and Organisational Review Committee referred to the United Kingdom "care and management" provision. At that time this provision was contained in section 1 of the Taxes Management Act 1970:

    1(1) Income tax, corporation tax and capital gains tax shall be under the care and management of the Commissioners of Inland Revenue (in this Act referred to as "the Board"), and the definition of "inland revenue" in section 39 of the Inland Revenue Regulation Act 1890 shall have effect accordingly.

36. Section 1 of the Taxes Management Act 1970 was repealed and replaced with section 5 of the Commissioners for Revenue and Customs Act 2005. Section 5(1) uses the term "collection and management of revenue", which section 51(3) provides has the same meaning as "care and management".

37. The House of Lords considered section 1 of the Taxes Management Act 1970 in *Inland Revenue Commissioners v National Federation of Self-Employed and Small Businesses Ltd* [1981] 2 All ER 93 ("*Fleet Street Casuals* case"). In this decision, casual workers in the printing industry had "engaged in a process

of depriving the Inland Revenue of tax due on their casual earnings". The casual workers had falsified their identities and addresses when collecting their pay, so that the Inland Revenue could not assess and collect tax due from them.

38. To end this revenue loss, the United Kingdom Revenue entered an arrangement with the casual workers, the Union and the employers. By the terms of this arrangement:

- the casual workers would register with the Revenue in respect of their employment in order for future tax to be deducted at source or otherwise assessed, and to co-operate with the Revenue in settling their taxes for the previous two year period; and
- the Revenue agreed not to investigate tax liability of these casual workers in years before the past two years.

39. The respondent sought a writ of mandamus to compel the United Kingdom Revenue to act contrary to this arrangement by discharging their statutory duty to assess and collect all taxes owed by the casual workers. In considering the application, the House of Lords held in *Fleet Street Casuals* that the Revenue had a "wide managerial discretion" under section 1(1) of the Taxes Management Act 1970. Lord Diplock stated that this discretion was inherent in the phrase "care and management" (at page 101):

> … the Board are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection.

It is worth observing that section 6A(3) is very similar to the duty Lord Diplock stated was imposed by section 1 of the Taxes Management Act 1970.

40. Their Lordships held that the arrangement was within the managerial discretion conferred by section 1 of the Taxes Management Act 1970. Without the arrangement, attempting to collect the taxes from the casual workers would have been unlikely to produce any substantial sums of money (at pages 99–100 per Lord Wilberforce; at page 101 per Lord Diplock). Moreover, the arrangement was likely to lead to a greater collection of revenue, because it brought the casual workers into the taxation system and so enabled their future income to be taxed. As Lord Roskill stated (at page 121):

> To my mind it is clear beyond argument … that what was done was a matter of taxes management, and I can see no shadow of dereliction of duty by the [Revenue], or any suggestion of improper or unlawful conduct on their part. On the contrary, what they did seems to me to have been a matter of administrative common sense. Instead of wasting public time and money in seeking to collect taxes from persons whose names were unknown and whose ability to pay was therefore equally unknown, they made an arrangement which enabled taxes not hitherto able to be collected or in fact collected, collectable in the future at a cost to the general body of taxpayers of foregoing the collection of that which in reality could never have been collected.

41. Having considered the background to section 6 and section 6A, the rest of this Statement analyses the "care and management" responsibility, and its relationship with section 6A(3) and the rest of the Inland Revenue Acts, including section 6.

"Care and management"

Two interrelated responsibilities

42. Section 6A(2) provides:

> The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

43. Section 6A(2) provides that the Commissioner has two core responsibilities: the "care and management of the taxes covered by the Inland Revenue Acts" and "such other functions as may be conferred". This Statement is concerned only with the "care and management" responsibility.

44. The phrase "care and management" is not defined in the Tax Administration Act 1994, and the courts have not given it detailed consideration. The Commissioner considers that the phrase "care and management" means that he has two interrelated responsibilities.

45. The Commissioner is charged with the "care" of the taxes. This means that the Commissioner is responsible for promoting the integrity and effective functioning of the tax system. To discharge this responsibility, the Commissioner must seek to foster the tax system's capacity to function effectively in light of economic, commercial, technological and other changes. In the context of the current tax system, the promotion of the voluntary compliance system by the Commissioner is consistent with his "care" responsibility.

46. The Commissioner is also charged with the "management" of the taxes. This means he is responsible for making managerial decisions in the interests of bringing about the efficient and effective

administration of the tax system. The "management" responsibility also recognises that the Commissioner often exercises judgement about how he carries out his functions and deals with particular taxpayers. The need to exercise judgement arises, for instance, where the Inland Revenue Acts provide the Commissioner with alternative courses of action. For example:

- It is left to the Commissioner to design the audit strategy whereby the taxpayers that will be audited are selected.
- The Inland Revenue Acts provide the Commissioner with information gathering powers and specify the requirements for the lawful exercise of these powers. The Commissioner exercises judgement as to when he will exercise these powers.
- The Inland Revenue Acts may permit the Commissioner to enter into an instalment arrangement, or to institute enforcement proceedings, in order to recover outstanding tax from a particular taxpayer.

The Commissioner exercises judgement as to which of the alternative courses of action he will adopt.

47. The "management" responsibility also recognises that the Commissioner makes decisions about the allocation and management of his resources. The Commissioner has limited resources within which to carry out his functions, and this means there will be competing demands on those resources. The Commissioner must reconcile those competing demands. This involves him exercising judgement about the relative resources he allocates, over a period of time, across the various parts of Inland Revenue, and with respect to dealing with particular taxpayers.

48. This analysis of the "care and management" responsibility is consistent with the House of Lords' decision in *Fleet Street Casuals* and the legislative history of section 6A(2).

49. In the *Fleet Street Casuals* case, the House of Lords held that the United Kingdom "care and management" provision conferred on the Inland Revenue Commissioners managerial discretion as to the "best means" of collecting the taxes. Lord Diplock stated (at page 101):

> … the Board are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the board have a wide managerial discretion as to the best means of obtaining for the Exchequer from the taxes committed to their charge the highest net return that is practical having regard to the staff available to them and the cost of collection.

50. Similarly, Lord Roskill stated (at page 121) that the Commissioners were entitled to exhibit "administrative common sense" and to make "sensible arrangement[s] in the overall performance of their statutory duties in connection with taxes management". Finally, Lord Scarman stated that the legislation placed income tax under the Commissioners' care and management and, for that purpose, conferred on them "very considerable discretion in the exercise of their powers", and that (at page 111):

> In the daily discharge of their duties inspectors are constantly required to balance the duty to collect "every part" of tax due against the duty of good management. This conflict of duties can be resolved only by good managerial decisions, some of which would inevitably mean that not all the tax known to be due will be collected.

51. In light of the *Fleet Street Casuals* case, the Organisational Review Committee defined the phrase "care and management" for the purposes of its report as (ORC report, Glossary and Commonly Used Abbreviations, page 81):

> Managerial discretion as to the use of independent statutory powers in a cost effective manner.

52. The reference in this definition to the use of independent statutory powers in a "cost effective manner" reflects the main objective intended to be achieved by enacting section 6A(2). The Organisational Review Committee considered that enacting a "care and management" provision would remove (ORC report, Appendix D, Roles of the Commissioner and Chief Executive of IRD, paragraph 36):

> … some doubt … as to the extent to which the present wording of section 4 of the Inland Revenue Department Act, charging the Commissioner with 'administration' of the Inland Revenue Department Act implies that care and management of limited resources overrides the more specific tasks and duties of the Commissioner defined in the Inland Revenue Acts.

53. In contrast, the Committee considered that the phrase "care and management" explicitly recognised the Commissioner's "management of limited resources in the efficient and effective collection of taxes" and his "administrative discretion in the application of finite resources to the collection of taxes" (ORC report, sections 9.4.2 and 9.5.1, and Appendix D, paragraphs 35 and 37). As the ORC report suggests, the Committee considered that a "care and management" provision would legislatively recognise the Commissioner's need to make decisions concerning the discharge of his functions and how he would deal with particular

taxpayers. This is made clear elsewhere in the ORC report (ORC report, Appendix D, paragraph 36):

> Consistent with good management practice, care and management of limited resources should be applied by the [Commissioner] across the full range of functions of tax administration, including functions which are subject to the convention of managerial independence and the statutory independence of the Commissioner in administering the Revenue Acts.

Relationship between section 6A(2) and (3)

54. Until now, the focus has been on the meaning of the words "care and management" in section 6A(2). The next issue is the relationship between section 6A(2) and (3).

55. Section 6A(3) provides:

> In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—
>
> (a) The resources available to the Commissioner; and
>
> (b) The importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
>
> (c) The compliance costs incurred by taxpayers.

56. Section 6A(2) and (3) are considered together because section 6A(3) provides legislative guidance for the exercise of the "management" responsibility. Section 6A(3) applies "[i]n collecting the taxes committed to the Commissioner's charge". The collecting of taxes is part of the "management" responsibility in section 6A(2). As will be discussed, section 6A(3) clarifies the Commissioner's overall objective in carrying out his functions in administering the tax system: see paragraphs 95–103 below. This position is supported by the legislative history to section 6A(2) and (3). These provisions were enacted together (along with section 6) as a "legislative package" to provide the framework within which the Commissioner administers the tax system.

57. Further, as already noted, section 6A(3) is almost identical to the duty that Lord Diplock in *Fleet Street Casuals* identified as imposed by the United Kingdom "care and management" provision. In *Fairbrother v CIR*, Young J noted (at paragraphs 21 and 26) that this similarity was "not a coincidence". His Honour held that "[section] 6A must be regarded as statutory ratification of the approach adopted by the House of Lords in *Fleet Street Casuals*".

58. Section 6A(3) is more extensively analysed later in paragraphs 90–135.

Relationship with the other provisions of the Inland Revenue Acts

59. An issue arises about the extent to which section 6A(2) and (3) authorise the Commissioner to act inconsistently with the rest of the Inland Revenue Acts (including section 6).

60. One possible interpretation of the words "notwithstanding anything in the Inland Revenue Acts" in section 6A(3) is that section 6A(2) and (3) override all other provisions. Under this interpretation, the Commissioner could act inconsistently with any provision if he considers this would maximise the net revenue collected. It is acknowledged that passages in several High Court decisions appear to support this interpretation: see *Fairbrother v CIR*, at paragraph 26; *Raynel v CIR* (2004) 21 NZTC 18,583, at paragraph 49; *Accent Management Ltd v CIR* (2006) 22 NZTC 19,758 (HC), at paragraph 71. However, the Commissioner considers that this interpretation is incorrect, because Parliament did not intend section 6A(2) and (3) to override all other provisions.

61. In the Commissioner's view, the better interpretation is that section 6A(2) and (3) allow him to act inconsistently with the rest of the Inland Revenue Acts only to the extent that they can be seen to obligate him to "collect all taxes that are due regardless of the resources and costs involved" (*Fairbrother v CIR* (2000), at paragraph 27). This reflects Parliament's purpose in enacting section 6A(2) and (3). Before these provisions were enacted, the tax legislation at the time arguably required the Commissioner to seek to collect all taxes owing (subject only to the specific relief and remission provisions). Section 6A(2) and (3) were enacted to make clear that the Commissioner was under no such obligation, and that instead he has the duty of maximising the net revenue collected over time.

62. It might be noted that interpreting section 6A(2) and (3) as overriding all other provisions would seem to effectively alter the constitutional framework within which the tax system operates. Instead of administering the legislation as enacted by Parliament, the Commissioner would have an overarching discretion whether to give effect to it. Such an interpretation would seem to permit the Commissioner to maximise the net revenue collected by (for instance):

- disregarding legislative requirements or limitations imposed on him by Parliament (eg, by amending assessments to increase the assessed tax liability despite the four-year time limit having been exceeded); or

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- altering the statutory assessment basis by advising taxpayers to assess themselves other than in accordance with the legislation.

63. The Commissioner considers that Parliament did not intend section 6A(2) and (3) to alter the constitutional framework within which the tax system operates. This is supported by section 6A(3) requiring the Commissioner to "collect over time the highest net revenue that is practicable **within the law**" (emphasis added). The words "within the law" indicate that Parliament intended to legally constrain the Commissioner's ability to maximise the net revenue collected: they require him to act consistently with the specific constraints and obligations imposed on him by other provisions.

64. This interpretation is supported by *Kemp v CIR* (1999) 19 NZTC 15,110. In that decision, the High Court held that the Commissioner could not disregard section 414A(5) of the Income Tax Act 1976. Section 414A(5) required the Commissioner to obtain ministerial approval before remitting more than $50,000 tax. Robertson J held that section 6A(2) and (3) did not confer a "general dispensing power" on the Commissioner (at page 15,117):

> I accept the argument of the Commissioner that even if a general power to enter into settlements with taxpayers exists, it would not override the specific requirements laid down by Parliament for the exercise of powers of remission in Part XVI of the IT Act. If this were the case, it would be possible for the Commissioner to avoid the limitations on his discretionary power merely by omitting to take one of the steps specified in sections such as s 414A and then claiming recourse to a general power. To allow such an unbridled discretion can not have been the intention of Parliament. I agree with the Commissioner that this would allow through a "back door" that which does not meet the explicit statutory requirements.

Therefore the Commissioner was required to comply with section 414A(5) and, in this case, had acted unlawfully in failing to do so.

Implications of conclusions on the relationship between section 6A(2) and (3) and the other provisions of the Inland Revenue Acts

65. Paragraphs 66–86 below discuss some of the important implications of the Commissioner's conclusions on the extent to which section 6A(2) and (3) authorise him to act inconsistently with the other provisions of the Inland Revenue Acts. This discussion is intended to assist in clarifying what the Commissioner can and cannot do under section 6A(2) and (3). The important implications discussed are that section 6A(2) and (3) do not authorise the Commissioner to:

- disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- alter taxpayers' obligations and entitlements;
- issue extra-statutory concessions;
- administratively remedy legislative errors and other deficiencies; or
- interpret provisions other than in accordance with statutory interpretation principles contained in the Interpretation Act 1999 and court decisions.

The relationship between section 6A(2) and (3) and section 6 is another important issue, and this is discussed later in paragraphs 136–150.

Commissioner cannot disregard the requirements for the lawful exercise of the powers and discretions conferred by other provisions.

66. It follows from the Commissioner's conclusions that section 6A(2) and (3) do not affect the requirements for the lawful exercise of the powers and discretions conferred on him by other provisions. If the requirements for the lawful exercise of a particular power or discretion are not satisfied, section 6A(2) and (3) do not authorise the Commissioner to exercise that power or discretion nevertheless. Similarly section 6A(2) and (3) do not allow the Commissioner to disregard explicit legislative directions or prohibitions on how he must or must not act. Accordingly, section 6A(2) and (3) do not allow the Commissioner to (for example):

- exercise search and seizure powers, or to retain seized property, other than in accordance with the provisions governing the exercise of these powers (*Singh v CIR* (1999) NZTC 15,050);
- recover outstanding tax inconsistently with section 176(2)(b), which prohibits the recovery of outstanding tax to the extent it would place the taxpayer, being a natural person, in "serious hardship" (*W v CIR* (2005) 22 NZTC 19,602, at paragraph 24); or
- write-off outstanding tax inconsistently with section 177C(3), which prohibits the writing-off of outstanding tax in certain circumstances (*Raynel v CIR*, at paragraph 61; *Clarke & Money v CIR* (2005) 22 NZTC 19,165, at paragraph 25; *Rogerson v CIR* (2005) 22 NZTC 19,260, at paragraph 51).

67. In the same way, section 6A(2) and (3) do not allow the Commissioner to carry out courses of action that are unlawful under another enactment or rule of law.

For instance, section 6A(2) and (3) do not authorise the Commissioner to decide not to respond to information requests within the period required by the Official Information Act 1982.

68. Further, section 6A(2) and (3) do not authorise the Commissioner to carry out actions that he does not have the power to do. For instance, if the Commissioner were prevented from writing off tax under section 177C (which provides the Commissioner with discretion to write off outstanding tax) or any other provision, the Commissioner could not write off that tax under section 6A(2) and (3).

However, the Commissioner could decide not to allocate the resources required to collect outstanding tax from a particular taxpayer. This would involve the exercise of the managerial discretion as to the allocation and management of resources. If the Commissioner were to make such a decision, he would not be writing-off the outstanding tax but rather only deciding not to take the steps required to collect the tax. The taxpayer's liability to pay that tax would remain despite the Commissioner's resource decision.

Commissioner cannot alter taxpayers' obligations and entitlements

69. Another implication of the Commissioner's conclusions is that section 6A(2) and (3) do not allow him to alter taxpayers' legislative obligations and entitlements. The Commissioner can alter taxpayers' obligations and entitlements only if authorised by another provision. For example, section 6A(2) and (3) do not authorise the Commissioner to:

- collect more tax than imposed by the legislation;
- amend taxpayers' assessments other than in accordance with the statutory assessment basis (*Vestey v IRC* [1979] 3 All ER 976);
- contract with taxpayers as to their tax liability in future years (*Ali Fayed v IR Commrs* [2006] BTC 70); and
- grant legislative entitlements to taxpayers who are not eligible under the legislation *(R (on the application of Wilkinson) v IRC* [2005] UKHL 30).

70. Similarly, the Commissioner cannot advise taxpayers that they are not required to comply with their tax obligations. The Commissioner could not, for instance, direct taxpayers to assess themselves other than in accordance with the statutory assessment basis. Taxpayers' obligations are imposed on taxpayers by the legislation itself, and the tax liability is payable independently of its assessment: *CIR v Lemmington Holdings* (1982) 5 NZTC 61,268 (CA); *Reckitt and Colman (New Zealand) Ltd v Taxation Board of Review* [1966] NZLR 1032; *Westpac Banking Corp v CIR* (2009) 24 NZTC 23,340. This is made clear by section 15B of the Tax Administration Act 1994:

> **15B Taxpayer's tax obligations**
>
> A taxpayer must do the following:
>
> (aa) If required under a tax law, make an assessment:
>
> (a) Unless the taxpayer is a non-filing taxpayer, correctly determine the amount of tax payable by the taxpayer under the tax laws:
>
> (b) Deduct or withhold the correct amounts of tax from payments or receipts of the taxpayer when required to do so by the tax laws:
>
> (c) Pay tax on time:
>
> (d) Keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws:
>
> (e) Disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose:
>
> (f) To the extent required by the Inland Revenue Acts, co-operate with the Commissioner in a way that assists the exercise of the Commissioner's powers under the tax laws:
>
> (g) Comply with all the other obligations imposed on the taxpayer by the tax laws.
>
> (h) If a natural person to whom section 80C applies, inform the Commissioner that the person has not received an income statement for a tax year, if the income statement is not received by the date prescribed by section 80C(2) or (3):
>
> (i) If the taxpayer is a natural person, correctly respond to any income statement issued to the taxpayer.

71. It follows that if the Commissioner were to inform taxpayers that they are not required to comply with their tax obligations, he would be purporting to suspend the operation of the Inland Revenue Acts. This would be inconsistent with Article 1 of the Bill of Rights 1688 (Imp), which declares illegal the "suspending of laws … by Regall Authority without consent of Parlyment". Given the Commissioner is an officer of the Crown and collects the tax as the statutory agent of the Crown (*Cates v CIR* (1982) 5 NZTC 61,237 (CA)), such a statement would arguably imply that "what was being done was lawful and had legal effect" (*Fitzgerald v Muldoon* [1976] 2 NZLR 615).

72. While the Commissioner cannot purport to alter taxpayers' obligations and entitlements, section 6A(2) and (3) do authorise him to decide not to allocate the resources required to collect the full amount of taxes imposed by another provision. If the Commissioner were to make such a decision, with the result that not all taxes are collected, he is not dispensing

with the provisions imposing the tax liability. The Commissioner's resource allocation and management decisions are administrative acts that do not affect the underlying tax liability. Taxpayers are obliged to pay the full amount of tax imposed regardless of whether the Commissioner decides to allocate resources to collect it.

Extra-statutory concessions

73. It has been occasionally suggested that section 6A(2) and (3) authorise the Commissioner to issue what are sometimes called extra-statutory concessions. In the United Kingdom, HM Revenue & Customs has issued extra-statutory concessions since at least 1947. It defines "extra-statutory concession" as ("Extra-Statutory Concessions – ex-Inland Revenue" (Concessions as at 31 August 2005), at page 2 available at: HM Revenue & Customs website **www.hmrc.gov.uk**):

> … a relaxation which gives taxpayers a reduction in tax liability to which they would not be entitled under the strict letter of the law. Most concessions are made to deal with what are, on the whole, minor or transitory anomalies under the legislation and to meet cases of hardship at the margins of the code where a statutory remedy would be difficult to devise or would run to a length out of proportion to the intrinsic importance of the matter.

This definition indicates that extra-statutory concessions reduce the tax liability otherwise imposed by the legislation, and in this sense they purport to alter taxpayers' legal obligations and entitlements.

74. As was discussed earlier in paragraphs 69–72, section 6A(2) and (3) do not allow the Commissioner to alter taxpayers' obligations and entitlements. Therefore it follows that section 6A(2) and (3) do not authorise the issuing of extra-statutory concessions. This position is supported by the fact that, despite the well-established practice in the United Kingdom, neither the Valabh report nor the ORC report suggests that it was intended that any New Zealand "care and management" provision would authorise the issuing of extra-statutory concessions.

75. As an aside, it is noted that HM Revenue & Customs considers that the House of Lords' decision in *R (on the application of Wilkinson) v IRC* (discussed in paragraphs 83–84 below) indicates that its ability to issue extra-statutory concessions is more limited than previously considered: Finance Bill 2008, Clause 154, Explanatory Note, paragraphs 12–13. As a consequence, section 160 of the Finance Act 2008 (UK) was enacted to enable extra-statutory concessions issued before 2008 to be given statutory effect. Section 160(1) provides that "[t]he Treasury may by order make provision for and in connection with giving effect to any existing HMRC concession."

Commissioner cannot administratively remedy legislative errors and other deficiencies

76. The Commissioner's conclusions also mean that section 6A(2) and (3) do not authorise him to administratively remedy legislative errors and other deficiencies. Similarly these provisions do not authorise the Commissioner to avoid or reduce the undesirable effects of legislative obligations imposed on taxpayers or the Commissioner. Legislative errors and deficiencies can be remedied only by Parliament.

77. The House of Lords has taken a similar position with respect to the United Kingdom "care and management" provision.

78. In *Vestey v IRC* the House of Lords considered section 142 of the Income Tax Act 1952 (UK). As interpreted by earlier courts, section 142 made each beneficiary fully liable for the tax on the total income of the trust. This meant that section 142 imposed double taxation where multiple beneficiaries derived income from a discretionary trust, because it did not provide any means of apportioning the total tax liability amongst the beneficiaries. It was unlikely that the United Kingdom Parliament intended this result. To remedy this apparent legislative deficiency, the United Kingdom Commissioners adopted a policy whereby the total tax liability was apportioned between the beneficiaries.

79. The House of Lords held that the Commissioners had no authority to adopt this policy. The policy "involved … not one of construction, even one of strained construction, [of the legislation] but … one of rewriting the enactment" (per Lord Wilberforce, at page 983). Although the House of Lords acknowledged that the policy was intended to "mitigate the gross injustice" of the provision, the Commissioners had no authority to act contrary to the provision because it was mandatory (per Viscount Dilhorne, at page 994). No other provision in the tax legislation provided any "statutory support" for the policy adopted by the Commissioners (per Lord Edmund-Davies, at page 1002).

80. Lord Wilberforce identified "fundamental objections" to this policy. The discretion claimed by the Commissioners was inconsistent with Parliamentary sovereignty and with the constitutional maxim that Parliament alone imposes taxes. His Lordship stated (at pages 984–985):

> Taxes are imposed upon subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined.

> A proposition that whether a subject is to be taxed or not, or, if he is, the amount of his liability, is to be decided (even though within a limit) by an administrative body represents a radical departure from constitutional principle. It may be that the Revenue could persuade Parliament to enact such a proposition in such terms that the courts would have to give effect to it: but, unless, it has done so, the courts, acting on constitutional principles, not only should not, but cannot validate it.

81. His Lordship rejected the Commissioners' submission that their "general administrative discretion in the execution of" the tax legislation provided the legal basis for the policy (at page 985):

> When Parliament imposes a tax, it is the duty of the commissioners to assess and levy it upon and from those who are liable by law. Of course they may, indeed, should act with administrative commonsense. To expend a large amount of taxpayer's money in collecting, or attempting to collect, small sums would be an exercise in futility; and no one is going to complain if they bring humanity to bear in hard cases. I accept also that they cannot, in the absence of clear power, tax any given income more than once. But all this falls far short of saying that so long as they do not exceed a maximum they can decide that beneficiary A is to bear so much tax and no more, or that beneficiary B is to bear no tax.
>
> This would be taxation by self-asserted administrative discretion and not by law … "one should be taxed by law, and not be untaxed by concession".

82. Lord Wilberforce acknowledged that the Commissioners had "done their best to devise a system which is workable and reasonably fair". Nevertheless the Commissioners had no legal authority to remedy the legislative deficiency (at page 986):

> But whatever system they might devise lacks any legal basis. I must regard this case therefore as one in which Parliament has attempted to impose a tax, but in which it has failed, in the case of discretionary beneficiaries, to lay down any basis on which it can be assessed or levied. In the absence of any such basis the tax must fail.

83. More recently in *R* (*on the application of Wilkinson*) *v IRC*, the House of Lords considered whether the United Kingdom "care and management" provision authorised HM Revenue & Customs to extend to widowers an allowance that the legislation provided only to widows. Wilkinson submitted that the "care and management" provision authorised HM Revenue & Customs to extend the allowance to widowers, and that this should be done to comply with the United Kingdom's international obligations to eliminate gender discrimination.

84. The House of Lords rejected this submission. It held that the "care and management" provision could not authorise the Commissioners to grant the allowance to widowers. Lord Hoffmann acknowledged that the "care and management" provision conferred on the Commissioners wide managerial discretion as to the best means of collecting the taxes, but this did not (at paragraphs 21–22):

> [21] … enable the commissioners to concede, by extra-statutory concession, an allowance which Parliament could have granted but did not grant, and on the grounds not of pragmatism in the collection of tax but of general equity between men and women.
>
> [22] It follows that in my opinion the legislation gave the commissioners no power to act otherwise than to disallow claims for allowances by widowers …

85. In *Vestey* and *Wilkinson* the House of Lords held that the United Kingdom "care and management" provision does not enable legislative errors and deficiencies to be administratively remedied. This is entirely consistent with the Commissioner's view of the relationship between section 6A(2) and (3) and the other provisions of the Inland Revenue Acts.

Role of the "care and management" responsibility and section 6A(3) in statutory interpretation

86. Another important implication of the Commissioner's conclusions is that section 6A(2) and (3) do not justify him interpreting other provisions in the Inland Revenue Acts other than in accordance with statutory interpretation principles. For instance, the Commissioner cannot prefer one interpretation, over another competing interpretation, on the basis that it will result in the highest net revenue being collected over time. The other provisions in the Inland Revenue Acts must be interpreted only according to the principles of statutory interpretation contained in the Interpretation Act 1999 and in court decisions.

Delegation and guidelines

87. As already stated, the "management" responsibility recognises that the Commissioner often exercises judgement as to how he carries out his functions and deals with particular taxpayers. This means that the "management" responsibility is not only relevant with respect to "high-level" managerial decision-making. It is also relevant with respect to the making of day-to-day managerial decisions concerning particular taxpayers.

88. As with his other powers and discretions, it is for the Commissioner to prescribe which officers have the delegated authority to make decisions under section 6A(2) and (3). In addition the Commissioner may from time-to-time issue guidelines so as to ensure that across Inland Revenue there is consistent decision-making under section 6A(2) and (3). These guidelines

will assist in protecting the integrity of the tax system as required by section 6, by ensuring "recognition of the relevant criteria and a proper degree of consistency in the exercise of discretions": *CIR v Wilson* (1996) 17 NZTC 12,512 (CA).

89. The Organisational Review Committee considered that guidelines would help to ensure that "perceptions of the integrity of the tax system are not diminished". It noted that particular taxpayers may be concerned about the application of the Commissioner's authority to enter settlements, and that some taxpayers "may also attempt to take advantage of the apparently increased discretion". The Committee therefore recommended (ORC report, Appendix D, at paragraphs 48–49):

> To ensure the proper and consistent use of managerial responsibility in these areas, the tax administration will be required to refine or develop internal guidelines for the exercise of care and management in the administration of the Inland Revenue Acts. The guidelines should be consistent with the objective of maximising net revenue over time according to the law and give guidance to staff on the proper procedures and considerations to take into account as they apply tax law.

Section 6A(3): Duty to collect over time the highest net revenue that is practicable within the law

Overview of section 6A(3)

90. Section 6A(3) provides:

> In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—
>
> (a) The resources available to the Commissioner; and
>
> (b) The importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
>
> (c) The compliance costs incurred by taxpayers.

91. Section 6A(3) requires the Commissioner to identify the available courses of action for administering the tax system or for dealing with particular taxpayers. These courses of action must be "within the law". Section 6A(3) then requires the Commissioner to evaluate these courses of action by considering their likely effect on the amount of net revenue collected over time, and by having regard to the three factors in section 6A(3)(a), (b) and (c).

92. Once the Commissioner has identified the course of action that is consistent with the duty to "collect over time the highest net revenue that is practicable within the law", the words "notwithstanding anything in the Inland Revenue Acts" authorise the Commissioner to undertake that course of action even if it will result in less tax being collected than is imposed, or required to be collected, by the other provisions of the Inland Revenue Acts.

93. In deciding which course of action is consistent with section 6A(3), the Commissioner will generally consider the circumstances of the particular taxpayers or groups of taxpayers concerned. However, the Commissioner may also from time to time issue general statements of policy that set out the course of action he will take in particular types of situations.

94. The text of section 6A(3) is analysed in the following paragraphs.

Scope of section 6A(3): "In collecting the taxes committed to the Commissioner's charge"

95. Section 6A(3) applies when the Commissioner is "collecting the taxes committed" to his charge. Neither the courts nor the Organisational Review Committee has commented on the meaning of the word "collecting".

96. The word "collecting" could be construed as meaning the actual receiving or taking possession of taxes. Under this narrower interpretation, section 6A(3) would apply only when the Commissioner seeks to recover the taxes assessed as owing, for instance when deciding whether to exercise enforcement powers or instead enter an instalment arrangement. This means that section 6A(3) would apply with respect to the Commissioner's actions after the tax liability has been assessed, but would not cover his actions **before** the tax liability has been assessed or that relate to ensuring the correct assessment of tax.

97. It is considered that the better view is that the word "collecting" has a broader meaning: it refers to the Commissioner's functions that relate to, or enable, the receiving or taking possession of taxes. Under this, more holistic, interpretation section 6A(3) applies to the Commissioner's functions both before and after the tax liability has been assessed. It would also include a wide range of administrative and support functions undertaken by the Commissioner, and also the Commissioner's actions that relate to ensuring the correctness of taxpayers' assessments (eg, the exercise of audit and investigative powers and reassessment powers).

98. The narrower interpretation gives the word "collecting" a meaning it can have in isolation. However, the Commissioner considers that the broader interpretation is to be preferred, because

it is consistent with the statutory context and gives better effect to the purpose of section 6A(3). The Organisational Review Committee envisaged that the section 6A(3) duty would be the "overall objective" of the "total tax system" (see ORC report, section 8.2). Section 6A(3) would have this function under the broader interpretation of the word "collecting", because it would apply to every aspect of the Commissioner's administration of the tax system.

99. It is relevant to note that the Organisational Review Committee adopted the words "in collecting the taxes committed to the Commissioner's charge" as a result of the Valabh Committee's recommendation that (Valabh report, page 8):

> Such a change in the legislation [ie, the adoption of a provision similar to the United Kingdom "care and management" provision] would have to be presented and implemented with due care. It would be important to emphasise for instance that the taxes are committed to the Commissioner's *charge*. Taxpayers may try to take advantage of an apparently increased discretion …

100. This indicates that the words "in collecting the taxes committed to the Commissioner's charge" were not intended to confine section 6A(3) to the actual receiving or taking possession of taxes. Instead the addition of these words was considered necessary to guard against taxpayers improperly taking advantage of "an apparently increased discretion" brought about by enacting a "care and management" provision (Valabh report, at page 7).

101. This in turn highlights a nuance inherent in the words "in collecting the taxes committed to the Commissioner's charge". The words "committed to the Commissioner's charge" emphasise that decisions concerning the collection of the taxes are those of the Commissioner alone. These words accordingly make it clear that section 6A(3) does not provide taxpayers with any basis for expecting that they will not be required to comply with their tax obligations.

102. In summary, the words "in collecting the taxes committed to the Commissioner's charge" cover all the Commissioner's functions that relate to, or enable, the receiving or taking possession of taxes. As a result, section 6A(3) applies whenever the Commissioner exercises the managerial discretion conferred by the "care and management" responsibility.

103. It is important to note that this conclusion concerns only the ambit of section 6A(3). It does not directly affect what the Commissioner can or cannot do to "collect over time the highest net revenue that is practicable within the law". The conclusions on the meaning of the words "within the law" and "notwithstanding anything in the Inland Revenue Acts" in section 6A(3) govern what courses of action the Commissioner can undertake to discharge the section 6A(3) duty: see paragraphs 127–130 below.

Duty to collect over time the highest net revenue that is practicable

104. Section 6A(3) requires the Commissioner to "collect over time the highest net revenue that is practicable".

105. The phrase "highest net revenue" is not defined in the Tax Administration Act 1994. The Organisational Review Committee defined these words as "actual revenue less administration (collection) costs" (ORC report, section 8.2, footnote 2). It defined "administrative costs" as the "costs incurred by the tax administration in assessing and collecting taxes" (ORC report, Appendix, "Glossary and Commonly Used Abbreviations", page 81).

106. The significance of the duty imposed by section 6A(3) was discussed in *Fairbrother v CIR*. In this decision, Young J noted the similarity between section 6A(3) and the obligation imposed by the United Kingdom "care and management" provision (recognised by Lord Diplock in *Fleet Street Casuals*). His Honour considered (at paragraphs 26–27) that section 6A(2) and (3) amounted to "statutory ratification" of the House of Lords' approach in *Fleet Street Casuals*. Consequently, there was no scope for an argument that the Commissioner was under "an absolute obligation to collect the right amount of tax" in the absence of explicit contrary statutory direction.

107. At the same time, section 6A(3) does not authorise the Commissioner to decide to collect only "some" taxes owing. The duty to collect the "highest net revenue" means the Commissioner is obliged to **maximise** the net revenue having regard to the relevant considerations in section 6A(3). Section 6A(3) requires the Commissioner to compare the available courses of action in terms of their effect on the amount of net revenue that he collects over time, both from the particular taxpayers concerned and from all taxpayers.

108. In making this comparison, the Commissioner must consider the short and long term implications of the available courses of action. This is required by the words "over time" in section 6A(3). The Organisational Review Committee discussed the meaning of the words "over time" (ORC report, section 8.2, footnote 1):

> The requirement to balance short term and long term considerations, and to have regard to the importance of promoting voluntary compliance, will be important

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moderating influences in circumstances where the objective may otherwise prompt an unnecessarily vigorous and short-term approach to revenue collection.

1. *Over time* indicates the obvious need for the tax administration to balance short and longer term implications of possible strategies before deciding on any particular course of action. *Over time* is intended to capture the concept of net present value (a valuation technique common to business as well as governments) and appears to be the best short and non-technical means of capturing the concept.

109. These comments highlight that the practical effect of the words "over time" is that the Commissioner may adopt courses of action that have the effect of forgoing the collection of the highest net revenue:

- in the short term, if he considers that this will enable the collection of more net revenue in the longer term; and
- from particular taxpayers, if he considers that this will enable more net revenue to be collected from all taxpayers.

Factors the Commissioner must have regard to: section 6A(3)(a), (b) and (c)

110. In determining which course of action is consistent with the duty to collect over time the highest net revenue that is practicable within the law, section 6A(3) requires the Commissioner to have regard to three factors. These factors are:

    (a) The resources available to the Commissioner; and

    (b) The importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and

    (c) The compliance costs incurred by taxpayers.

111. Section 6A(3) requires the Commissioner to consider and balance all three factors listed in section 6A(3). In *Raynel v CIR*, Randerson J outlined the exercise required by section 6A(3) (at paragraphs 50 and 52):

> [50] These qualifications to the Commissioner's duty mean that the Commissioner is not obliged to take steps to collect revenue regardless of issues of practicality, available resources, and costs incurred. Rather, the [Commissioner's] duty is to be approached on a pragmatic basis with proper regard to the likely benefits and the costs of achieving them.
>
> …
>
> [52] … But the considerations relevant to the exercise of the Commissioner's duty are not limited to issues of practicality, resources and costs. Importantly, the Commissioner is also required by section 6A(3)(b) to have regard to the importance of promoting compliance (especially voluntary compliance) by all taxpayers with the Inland Revenue Acts.

112. The factors in section 6A(3) provide the framework within which the Commissioner evaluates the short and long term implications of the available courses of action for dealing with particular situations. The word "and" after the first two factors indicates that the Commissioner must have regard to all of the factors when evaluating the available courses of action.

113. Section 6A(3) does not stipulate the weight to be given to each of the factors. It is considered that the weight to be given each factor will depend on the circumstances of the particular case. Thus, in *Raynel v CIR* Randerson J stated (at paragraph 56):

> It is difficult and undesirable to give precise guidelines to the Commissioner other than the statutory considerations themselves. It will be a matter for the Commissioner to carry out his duty, having regard to the relevant considerations as they apply in individual cases and circumstances.

114. Randerson J noted (at paragraph 73) that decisions made by the Commissioner pursuant to the "broad managerial responsibilities" given to him "essentially involve the exercise of judgment within the statutory framework". Consequently the Court would be "slow to interfere" with the proper exercise of the Commissioner's duties and discretions in relation to the recovery of outstanding taxes. (For similar comments see also *Rogerson v CIR*, at paragraph 63.)

115. In the following paragraphs, the three factors in section 6A(3) are discussed.

"Resources available to the Commissioner" (section 6A(3)(a))

116. This first factor reflects that the Commissioner has limited resources. It covers the financial, time and human (including technical knowledge and expertise) resources to which the Commissioner has access. This factor includes not only the resources currently "on hand", but also the opportunity costs of using these resources in terms of current and future competing demands for them elsewhere in the tax system.

"Importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts" (section 6A(3)(b))

117. This second factor consists of two interrelated parts: the promotion of compliance generally and the promotion of voluntary compliance in particular. Section 6A(3)(b) refers to the promotion of compliance by "all taxpayers", which emphasises that section 6A(3) is concerned with the highest net revenue collected from the tax system as a whole.

118. The relationship between this factor and the amount of net revenue collected is obvious. Greater

compliance results in more tax being collected. Greater **voluntary** compliance increases the net revenue collected by reducing the Commissioner's administration costs. As the Organisational Review Committee observed, the voluntary compliance model, on which the tax system is based, is the most cost-effective form of tax collecting (ORC report, section 8.2 and Appendix D, paragraph 22).

119. As a rule, compliance, especially voluntary compliance, by all taxpayers will be promoted by the Commissioner ensuring that taxpayers perceive that they will be required to comply fully with their tax obligations. In *Raynel v CIR* Randerson J held (at paragraph 54):

> Sections 6 and 6A(3)(b) emphasise that there is a broader public interest in the integrity of the tax system and in ensuring that taxpayers meet their obligations. Taxpayers who comply with the requirements of the Inland Revenue Acts are entitled to expect that appropriate and (where necessary) firm action is taken against taxpayers who shirk their obligations. If not, complying taxpayers will justifiably perceive there is a lack of integrity in the system and an unfair burden is cast on those who conscientiously comply with their obligations. As well, as Master Lang pointed out, the voluntary compliance scheme which is central to the proper functioning of the Inland Revenue Acts will be placed in jeopardy unless all taxpayers know that the Commissioner will act firmly and resolutely with those who do not meet their obligations and have no reasonable excuse for doing so.

120. In some situations, the Commissioner might consider that this factor supports "firm action" (eg, bringing enforcement and bankruptcy proceedings) being taken against non-complying taxpayers, for instance, where there has been a flagrant and on-going failure to comply and where recovery is dubious or is likely to result only in a relatively minor proportion of the overall debt being recovered: *Raynel v CIR*, at paragraph 55.

121. In other cases, the Commissioner might consider that such "firm action" does not need to be taken against non-complying taxpayers to collect over time the highest net revenue that is practicable. The Organisational Review Committee recognised this possibility (ORC report, section 8.2):

> The requirement to balance short term and long term considerations, and to have regard to the importance of promoting voluntary compliance, will be important moderating influences in circumstances where the objective [i.e., to collect over time the highest net revenue that is practicable within the law] may otherwise prompt an unnecessarily vigorous and short-term approach to revenue collection.

122. It is not possible to identify the cases where the Commissioner would take this approach. It can be said that, at the very least, the Commissioner would need to be satisfied that the circumstances of the non-compliance mean that any failure to take "firm action" would not potentially undermine voluntary compliance by all taxpayers and taxpayer perceptions of the integrity of the tax system.

"Compliance costs incurred by taxpayers" (section 6A(3)(c))

123. The third factor in section 6A(3) covers the costs to taxpayers in assisting the administration of the tax system. This factor does not include the cost of the tax liability. The Organisational Review Committee defined "compliance costs" as (ORC report, Glossary and Commonly Used Abbreviations, page 81):

> The costs to taxpayers of meeting their obligations under tax law and in meeting the requirements and practices of the tax administration.

124. Excessively high compliance costs can decrease the amount of net revenue collected by discouraging economic activity and endangering voluntary compliance (see ORC report, sections 1.8 and 11.1, and Appendix F, paragraph 51). However, the Organisational Review Committee recognised that taxpayers should expect to incur some compliance costs. This was because voluntary compliance systems (on which the New Zealand's tax system is based) necessarily require taxpayers to incur some costs in meeting their obligations (ORC report, Appendix F, paragraphs 5–7).

125. In the Commissioner's view, section 6A(3)(c) requires him to have regard to whether the available courses of action would result in taxpayers incurring increased compliance costs. However, section 6A(3)(c) does not mean that taxpayers should not incur any compliance costs, or that the Commissioner cannot take courses of action that increase taxpayers' compliance costs. Parliament contemplated that taxpayers would incur compliance costs as a result of them complying with their tax obligations, and due to the Commissioner exercising the powers conferred on him to ensure taxpayer compliance.

126. Section 6A(3)(c) will be primarily relevant in the development of systems and processes for administering the tax system. Consistent with this, the Organisational Review Committee stated (ORC report, section 11.3):

> The second place to tackle compliance costs is through the operational policies and procedures of the tax administration which have an immediate and direct effect

> on costs to taxpayers. Any steps that are taken ought to have regard to these considerations in the new proposed objective for IRD [ie, section 6A(3)] …

Section 6A(3)(c) will also be relevant with respect to dealing with specific taxpayers. For instance, the Commissioner might consider (having taken account of all other relevant factors) that two or more courses of action are equally open to him. In such a case, if one of those courses of action would result in the taxpayers incurring significantly more compliance costs, but all other things were equal, the Commissioner could take the view that he should not adopt this course of action because it would increase compliance costs unnecessarily.

What the Commissioner may do to discharge the section 6A(3) duty: "within the law" and "notwithstanding anything in the Inland Revenue Acts"

127. The words "within the law" and "notwithstanding anything in the Inland Revenue Acts" affect the courses of action the Commissioner can undertake to "collect over time the highest net revenue that is practicable".

128. These words were referred to earlier in this Statement when considering the relationship between section 6A(2) and (3) and the other provisions of the Inland Revenue Acts: see paragraphs 59–64 above. It was concluded in this discussion that section 6A(2) and (3) make clear that the Commissioner is not obligated to collect all taxes owing if doing so would not maximise the net revenue collected over time. Section 6A(2) and (3) allow the Commissioner to act inconsistently with other provisions only to the extent that they may otherwise be seen to require him to collect all taxes regardless of considerations such as costs and available resources. They do not authorise the Commissioner to act inconsistently with the rest of the Inland Revenue Acts to any greater extent.

129. In light of these conclusions, the Commissioner considers that the words "notwithstanding anything in the Inland Revenue Acts" mean that the Commissioner may carry out the course of action that he considers will "collect over time the highest net revenue that is practicable" even if it results in less tax being collecting than is imposed, or required to be collected, by another provision. The words "within the law" mean that the Commissioner must act consistently with the rest of the Inland Revenue Acts in seeking to "collect over time the highest net revenue that is practicable".

130. It is worth noting that section 6A(3) is not overridden by a later enacted provision unless Parliament specifically intended the later provision to do so. In *Raynel v CIR*, the High Court held (at paragraphs 63–67) that section 176(1) and (2)(a) were not to be interpreted as overriding section 6A(3). Although section 176(1) and (2)(a) were enacted later than section 6A(3), there was no evidence that Parliament specifically intended the later provisions to override section 6A(3). Further, interpreting section 176(1) and (2)(a) as overriding section 6A(3) was inconsistent with the words "notwithstanding anything in the Inland Revenue Acts" in section 6A(3). Accordingly, the Commissioner was required to act consistently with both section 176(1) and 2(a) and section 6A(3): see also *Clarke & Money v CIR*; *Rogerson v CIR*.

Summary of conclusions on section 6A(3)

131. Section 6A(3) requires the Commissioner to identify the various options for dealing with administering the tax system or for dealing with particular taxpayers.

132. Section 6A(3) then requires the Commissioner to determine which option would result in the collecting "over time" of the "highest net revenue that is practicable" from all taxpayers. In making this determination, the Commissioner is required to ascertain the short and long term implications of the available options and to have regard to all three factors listed in section 6A(3). These factors are:
    - the resources available to the Commissioner (section 6A(3)(a));
    - the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts (section 6A(3)(b)); and
    - the compliance costs incurred by taxpayers (section 6A(3)(c)).

133. The practical effect of the words "over time" is that the Commissioner may adopt courses of action that have the effect of forgoing the collection of the highest net revenue:
    - in the short term if he considers that this will enable the collection of more net revenue in the longer term; and
    - from particular taxpayers if he considers that this will enable more net revenue to be collected from all taxpayers.

134. The words "notwithstanding anything in the Inland Revenue Acts" in section 6A(3) mean the Commissioner may carry out the course of action that he considers will "collect over time the highest net revenue that is practicable" even if it results in less tax being collecting tax than is imposed, or required to be collected, by another provision. The words "within the

law" mean the Commissioner must act consistently with the rest of the Inland Revenue Acts in seeking to "collect over time the highest net revenue that is practicable".

135. Section 6A(3) is not overridden by a later enacted provision unless Parliament specifically intended the later provision to do so.

Section 6: Protection of the integrity of the tax system

136. Another important issue is the relationship between section 6A(2) and (3) and section 6. In paragraphs 143–150 below this relationship is discussed, beginning with an overview of section 6.

Overview of section 6

137. Section 6 provides:

> (1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.
>
> (2) Without limiting its meaning, "the integrity of the tax system" includes –
>
> (a) Taxpayer perceptions of that integrity; and
>
> (b) The rights of taxpayers to have their liability determined fairly, impartially, and according to law; and
>
> (c) The rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and
>
> (d) The responsibilities of taxpayers to comply with the law; and
>
> (e) The responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and
>
> (f) The responsibilities of those administering the law to do so fairly, impartially, and according to law.

138. Section 6(1) obligates the Commissioner, along with all other officers of Inland Revenue, to use "best endeavours" to protect the "integrity of the tax system". This obligation must be discharged "at all times" and "in relation to the collection of the taxes and other functions under the Inland Revenue Acts". These words mean that the section 6 obligation must be discharged by the Commissioner in all aspects of his administration of the tax system.

139. Section 6(1) obliges the Commissioner to use "best endeavours" to protect the integrity of the tax system. The phrase "best endeavours" is not defined in the Tax Administration Act 1994. The courts have held that the phrase "best endeavours" in other legislative contexts is to be given its ordinary meaning of "trying one's best in all the circumstances": *Association of University Staff Inc v The Vice-Chancellor of the University of Auckland* [2005] 1 ERNZ 224; *Centaur Investments Co Ltd v Joker's Wild Ltd* (2004) 5 NZCPR 675.

140. Section 6(2) identifies six factors that come within the term "integrity of the tax system". In providing that it applies "[w]ithout limiting its meaning", section 6(2) indicates that the list of factors is not exhaustive. The factors listed in section 6(2) are fundamental principles in tax law: *Westpac Banking Corp v CIR*. These factors show that the term "integrity of the tax system" is a multifaceted concept. Some factors may be more important or relevant than others, and there may be potential for conflict between particular factors: see *Westpac Banking Corp v CIR*.

141. There has been little detailed judicial discussion on section 6. In the Supreme Court judgment in *Westpac Banking Corp v CIR*, McGrath J noted (at paragraph 32):

> The purpose of s 6 is to incorporate protection of the integrity of the tax system in terms that clearly define what is sought to be protected. The [Organisational Review] Committee had earlier observed in its report that tax integrity included the interaction between the total tax community and individual taxpayers.

His Honour described (at paragraph 52) section 6 as imposing an "overarching duty on Ministers and departmental officials". In the High Court decision in *Miller v CIR* (2003) 21 NZTC 18,243, Baragwanath J stated (at 18,253):

> [Section 6] is a statutory expression of long-settled principles of the common law which impose strict standards of conduct upon those exercising public powers conferred for performance of their functions of serving the community.

(See also *Ch'elle Properties (NZ) Ltd v CIR* (2005) 22 NZTC 19,622, at paragraphs 105–106.)

142. Section 6 does not provide taxpayers with a basis for challenging the Commissioner's decisions. It does not render amenable to judicial review any conduct (not involving a decision) that might be said to be inconsistent with the obligation to protect the integrity of the tax system. Consequently, section 6 does not provide a means of challenging an assessment; assessments can be challenged only by way of the statutory objection procedure: *Russell v Taxation Review Authority* (2003) 21 NZTC 18,255 (CA), at paragraphs 34–36; *Tannadyce Investments Ltd v CIR* (2009) 24 NZTC 23,036, at paragraph 63. Further, section 6 does not create rights enforceable by

taxpayers such as those found in the New Zealand Bill of Rights Act 1990: *Russell v Taxation Review Authority*, at paragraph 47.

Relationship between section 6 and section 6A(2) and (3)

143. Having provided an overview of section 6, it is now possible to explain more fully the relationship between section 6 and section 6A(2) and (3).

144. Section 6 applies "in relation to the collection of taxes and other functions under the Inland Revenue Acts". These words mean that section 6 will apply when the Commissioner acts under section 6A(2) and (3).

145. As already discussed in paragraphs 59–64 and 127–130 above, section 6A(2) and (3) allow the Commissioner to act inconsistently with other provisions to the extent that they may otherwise be seen to require him to collect all taxes regardless of the costs and resources involved. In the Commissioner's view, section 6A(2) and (3) do not authorise him to act inconsistently with the rest of the Inland Revenue Acts to any greater extent.

146. This raises the issue of whether section 6 is **inconsistent** with section 6A(2) and (3). In the Commissioner's view there is no inconsistency. Section 6 does not require him to collect all taxes regardless of costs and resources involved. Instead section 6 requires the Commissioner to do his best in all the circumstances—to use "best endeavours"—to protect the integrity of the tax system when carrying out his functions and duties. This means that, when considering how he will act under section 6A(2) and (3), the Commissioner must consider, and take into account, the extent to which the available courses of action might undermine, or support, the integrity of the tax system as defined in section 6.

147. This is consistent with the case law. The courts have confirmed that the Commissioner must act consistently with both section 6 and section 6A(3). The Supreme Court and the Court of Appeal have emphasised that section 6 and section 6A together provide the framework within which the Commissioner administers the Inland Revenue Acts: *Auckland Gas Co Ltd v CIR* at paragraphs 32–33; *AG v Steelfort Engineering* (1999) 1 NZCC 61,030, at page 61,036. In *Westpac Banking Corp v CIR*, McGrath J held that sections 6 and 6A occupy a "central position in the legislative scheme" (at paragraph 52) and that they were "closely linked" (at paragraph 51):

> The Commissioner's duty to have regard to the importance of voluntary compliance, in collecting the highest net revenue practicable, is closely linked to the importance of public perceptions of the integrity of the system.

148. Similarly, in *Raynel v CIR*, the High Court observed that the Commissioner's obligations in section 6 and section 6A(3) were interrelated in that they reinforced each other (at paragraph 54):

> Sections 6 and 6A(3)(b) emphasise that there is a broader public interest in the integrity of the tax system and in ensuring that taxpayers meet their obligations. Taxpayers who comply with the requirements of the Inland Revenue Acts are entitled to expect that appropriate and (where necessary) firm action is taken against taxpayers who shirk their obligations. If not, complying taxpayers will justifiably perceive there is a lack of integrity in the system and an unfair burden is cast on those who conscientiously comply with their obligations. As well … the voluntary compliance scheme which is central to the proper functioning of the Inland Revenue Acts will be placed in jeopardy unless all taxpayers know that the Commissioner will act firmly and resolutely with those who do not meet their obligations and have no reasonable excuse for doing so.

149. The legislative history also supports the view that the Commissioner must act consistently with both section 6 and section 6A(3). The Organisational Review Committee considered that the section 6 obligation should inform every decision made within the tax system (ORC report, section 9.4.1). The Committee recognised that enacting a "care and management" provision made it "all the more important to ensure that perceptions of the integrity of the tax system are not diminished" (at paragraph 9.5.1). Nevertheless it considered that protecting the integrity of the tax system and maximising the net revenue collected were consistent objectives. Protecting the integrity of the tax system was "crucial" to maintaining voluntary compliance (ORC report, sections 8.2 and 9.3; and Appendix D, paragraph 33). The Committee stated (ORC report, section 15.1.4):

> A key component of obtaining the highest net revenue, by supporting voluntary compliance, rests on taxpayer perceptions of the integrity of the tax system. Perceptions about integrity are tightly linked to the impartial application if the law and the exercise of the administration's coercive powers and decision making powers with respect to the affairs of individual taxpayers.

150. In summary, the Commissioner must comply with section 6 when acting under section 6A(2) and (3). This means that when deciding how to act under section 6A(2) and (3), the Commissioner must consider, and take into account, the extent to which the available courses of action might undermine, or support, the integrity of the tax system as defined in section 6.

Settlements and agreements

151. The courts have held that, under section 6A(2) and (3), the Commissioner can enter into:

- Settlements where taxpayers dispute the interpretation of law or facts on which their liability has been assessed (*Accent Management Ltd v CIR* (2006) 22 NZTC 19,758 (HC); *Accent Management (No 2) v CIR* (CA); *Auckland Gas Co Ltd v CIR*; *AG v Steelfort Engineering*; and *Fairbrother v CIR*).
- Agreements as to the payment of outstanding tax, penalties and interest (*Raynel v CIR*).

152. The courts have explicitly held that the Commissioner can settle litigation on a basis that does not necessarily correspond to his view of the correct tax position if he considers that doing so is consistent with section 6A(3) and section 6: *Accent Management Ltd (No 2) v CIR* (CA); *Foxley v CIR* (2008) 23 NZTC 21,813. The courts have implicitly suggested that the Commissioner can give effect to settlements by way of an amended assessment, but it is not entirely clear whether this is done under section 6A(2) and (3), or only where authorised by another provision. However, it is clear that the Commissioner can amend an assessment under section 89C(d) to reflect the terms of a settlement: *Accent Management Ltd (No 2) v CIR* (CA).

153. That the Commissioner can settle litigation might seem inconsistent with the conclusion reached earlier that the Commissioner cannot alter taxpayers' obligations and entitlements: see paragraphs 69–73 above. However, the courts have made clear that the Commissioner is not exercising any power to alter taxpayers' obligations in entering settlements. The courts have held that settlements do not involve the Commissioner "assuming and exercising a power of dispensing with and suspending of laws, and the execution of laws, without consent of Parliament": *Accent Management Ltd v CIR* (HC) at paragraph 74.

154. In taking this position, the courts have emphasised that settlements are made where the taxpayer's obligations and entitlements are legitimately disputed and, therefore, the Commissioner will need to undertake litigation to collect the full amount of tax he considers owing. The courts have recognised that the Commissioner may consider, in light of the litigation risk, that the resources required could be better used elsewhere to maximise the net revenue collected. In *Accent Management Ltd (No 2) v CIR* (CA), William Young P held (at paragraph 15):

> This [the Commissioner's ability to enter settlements] represents an undoubted shift from the approach adopted in [Brierley Investments]. The change in policy is justified by recognition that the Commissioner has limited resources and the function of collecting "over time the highest net revenue that is practicable within the law". Major tax litigation is expensive and places a heavy strain on the human resources available to the Commissioner. The Commissioner must be permitted to make rational decisions as to how those resources can be best deployed. Further, "sensible litigation, including settlement, decisions" must necessarily allow for litigation risk.

155. In holding that the Commissioner is authorised to enter settlements, the courts have given effect to a key outcome intended to be achieved by enacting section 6A(2) and (3). The ORC report shows that it was specifically contemplated that section 6A(2) and (3) would authorise the Commissioner to enter settlements (ORC report, section 8.2):

> One significant implication from the objective [that the Commissioner will collect over time the highest net revenue that is practicable within the law] is that IRD will be entitled to enter into compromised settlements with taxpayers, rather than pursue the full amount of assessed tax, in cases where there are legitimate differences of view about the facts in dispute and the costs of litigation are high.

156. The courts have not specifically considered whether the Commissioner can settle tax disputes before litigation or the formal disputes process has started. The Commissioner considers that, in principle, there is no impediment to him doing so. The Commissioner may consider that settling will enable his resources to be better used to maximise the net revenue collected. The Commissioner's position and responsibilities before litigation or the formal disputes process has started are not inherently different to his position and responsibilities during litigation. However, the litigation processes often results in him possessing more information than he did before. Accordingly, the Commissioner will consider settling before litigation or the formal disputes process has started only if satisfied that he has sufficient information on which to make an informed decision. As with his other powers, the Commissioner will prescribe which officers have the delegated authority to decide whether to settle.

157. The case law is clear that the Commissioner can enter settlements with taxpayers if he considers doing so is consistent with section 6A(3) and section 6. It is not possible to list all the factors the Commissioner may consider in deciding whether to settle. Ultimately the decision must be determined by consideration of all factors relevant to the particular case. However, the

following, non-exhaustive list identifies some of the factors the Commissioner could consider relevant (depending on the circumstances of the particular case):

- the resources required to undertake litigation;
- the alternative uses of those resources;
- the amount of the tax liability at stake;
- an assessment of the litigation risk (eg, the likelihood of the Commissioner succeeding);
- the implications of the Commissioner succeeding (in whole or part) if litigation is undertaken;
- whether settling or litigating would better promote compliance, especially voluntary compliance, by all taxpayers;
- the amount the taxpayer would pay if the Commissioner were to settle;
- whether the subject matter of the dispute might be determinative of, or have broader application to, other situations;
- whether the Commissioner would be prepared to settle on an equivalent basis with other taxpayers in a similar position;
- the uncertainty in the tax system that might be created should the subject matter not be authoritatively determined by the courts; and
- the likely effects on taxpayer perceptions of the integrity of the tax system of settling or litigating.

158. As already stated, the factors identified above are not exhaustive. Some of these factors may not be relevant and additional factors may be relevant given the circumstances of any particular case. It is for the Commissioner to decide on the appropriate weighting given to the relevant factors in a particular case.

159. Tax disputes sometimes involve several taxpayers. The Commissioner may need to decide whether to settle with each of the taxpayers individually. In such situations, the Commissioner is not required to settle, or to settle on the same terms, with all taxpayers involved in the litigation: *Accent Management Ltd v CIR* (HC), at paragraphs 79–86; and *Accent Management Ltd v CIR (No 2)* (CA), at paragraphs 20–22. However, the Commissioner will be aware that consistency of treatment for taxpayers with the same circumstances is an important consideration under section 6A(3) and section 6. Accordingly, in tax disputes involving several taxpayers, the Commissioner will generally settle on an equivalent basis with those taxpayers he considers share the same circumstances. By contrast, the Commissioner may settle on a different basis with those taxpayers he considers are in different circumstances. Different circumstances might include, for example, the taxpayer's willingness to settle, the timing of the settlement offers in relation to the progress of the litigation proceedings, the state of the case law at the time, and the Commissioner's perception of the culpability of the taxpayers involved: *Accent Management Ltd v CIR (No 2)* (CA) at paragraph 21. Because settlements reflect the circumstances of the particular litigation and of the taxpayers, they are not necessarily indicative of how the Commissioner will deal with similar issues in the future.

160. In deciding whether to settle litigation, the Commissioner will act consistently with the Protocol between the Solicitor-General and Commissioner of Inland Revenue, dated 29 July 2009 (available at the Crown Law Office website: **www.crownlaw.govt.nz**). This means that the Commissioner will consult with the Solicitor-General, who is responsible for the conduct of Crown litigation; and that litigation settlements will be jointly approved by Crown Law and Inland Revenue (except where the settlements concern debt matters and summary prosecution in which Inland Revenue solicitors represent the Commissioner). The Commissioner may also consult the Solicitor-General before entering a pre-litigation settlement if the subject-matter is central to a significant dispute in litigation.

161. Finally, where the Commissioner has entered into a settlement or agreement, he will not resile from it except if:

- the Commissioner is acting pursuant to a condition in the settlement or agreement that allows him to resile;
- the taxpayer has failed to adhere to the settlement or agreement; or
- the settlement or agreement was entered into on account of misrepresentations by the taxpayer, or the taxpayer failed to make full disclosure before the settlement or agreement was entered into.

Outline of "care and management" principles

162. Before turning to consider the examples, it is helpful to summarise the principles identified in this Statement's analysis of the "care and management" responsibility. This summary is then used to address the examples.

163. The phrase "care and management" indicates that the Commissioner has two interrelated responsibilities.

164. First, the Commissioner is charged with the "care" of the taxes. This means that the Commissioner is responsible for promoting the integrity and effective functioning of the tax system. To discharge this responsibility, the Commissioner must seek to foster the tax system's capacity to function effectively in light of economic, commercial, technological and other changes.

165. Second, the Commissioner is charged with the "management" of the taxes. This means that he is responsible for making managerial decisions in the interests of bringing about the efficient and effective administration of the tax system. The "management" responsibility recognises that the Commissioner makes decisions as to the allocation of his limited resources. This involves the Commissioner exercising judgement as to relative resources he allocates, over a period of time, across the various parts of Inland Revenue, and with respect to dealing with particular taxpayers. The "management" responsibility also recognises that the Commissioner often exercises judgement as to how he carries out his functions.

166. Section 6A(2) and (3) were enacted together (along with section 6) to provide the framework within which the Commissioner administers the tax system. Section 6A(3) applies "[i]n collecting the taxes committed to the Commissioner's charge". The collecting of taxes is an aspect of the Commissioner's "management" responsibility. Section 6A(3) clarifies the Commissioner's overall objective in carrying out his functions in administering the tax system.

167. In order to discharge his section 6A(3) duty, the Commissioner must compare the available courses of action as to their likely effect on the amount of net revenue he collects over time. To do this the Commissioner must consider the short and long term implications of each course of action, and have regard to all three factors listed in section 6A(3). These factors are:

- the resources available to the Commissioner (section 6A(3)(a));
- the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts (section 6A(3)(b)); and
- the compliance costs incurred by taxpayers (section 6A(3)(c)).

168. The practical effect of the words "over time" is that the Commissioner can adopt courses of action that have the effect of forgoing the collection of the highest net revenue:

- in the short term, if he considers that this will enable the collection of more net revenue in the longer term; and
- from particular taxpayers, if he considers that this will enable more net revenue to be collected from all taxpayers.

169. The words "notwithstanding anything in the Inland Revenue Acts" in section 6A(3) mean that the Commissioner can carry out the course of action that he considers will "collect over time the highest net revenue that is practicable" even if it results in less tax being collected than is imposed, or required to be collected, by another provision. The words "within the law" mean that the Commissioner must act consistently with the rest of the Inland Revenue Acts.

170. Some important implications of these conclusions are that section 6A(2) and (3) do not authorise the Commissioner to:

- disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- alter taxpayers' obligations and entitlements;
- issue extra-statutory concessions;
- administratively remedy legislative errors and other deficiencies;
- interpret provisions other than in accordance with the statutory interpretation principles contained in the Interpretation Act 1999 and court decisions; or
- act inconsistently with his obligation under section 6 to protect the integrity of the tax system.

171. Section 6(1) requires that the Commissioner, at all times, use best endeavours to protect the integrity of the tax system. The term "integrity of the tax system" is non-exhaustively defined in section 6(2). The Commissioner must comply with section 6 when acting pursuant to section 6A(2) and (3). This means that when deciding how to act under section 6A(2) and (3), the Commissioner must consider, and take into account, the extent to which the available courses of action might undermine, or support, the integrity of the tax system.

Examples

172. The following examples illustrate the principles set out in this Statement on the Commissioner's "care and management" responsibility in section 6A(2) and his obligations under section 6A(3) and section 6. The examples are not intended to state definitively what the Commissioner would do in the particular fact scenarios. Instead the examples are intended to assist readers' understanding of the Commissioner's view on:

- what he can and cannot do under section 6A(2) and (3);
- the decision-making process required by section 6A(3), and
- the application of the relevant factors in section 6A(3) and section 6.

Example 1: Decision whether to audit

The Commissioner has decided not to audit plumbers this year, due to their high degree of voluntary compliance and the low likelihood of identifying any undisclosed income. The Commissioner becomes aware of information that shows XYZ Plumbers has not declared $100,000 of income. In the normal course of events, XYZ Plumbers would not be audited because of the Commissioner's decision not to audit plumbers this year. Can the Commissioner decide to treat XYZ Plumbers like all the other plumbers by not auditing it?

173. The Commissioner could decide not to allocate the resources required to audit XYZ Plumbers. This decision would involve the Commissioner exercising the resource allocation discretion recognised by the "care and management" responsibility. However, before the Commissioner would decide not to allocate the resources required to audit, he would consider whether doing so is consistent with section 6A(3) and section 6. On the facts of this example, it would seem unlikely that the Commissioner would be acting consistently with section 6A(3) and section 6 by not auditing a taxpayer he has reason to believe has not declared a substantial amount of income.

Example 2: Decision not to investigate past years' tax liability

The Commissioner is aware that non-compliance is widespread in a particular industry. To address this non-compliance and to avoid further revenue loss, the Commissioner is proposing to inform the industry members that he will not audit their previous years' income if they comply with their tax obligations in current and future years.

Would the Commissioner's proposed course of action be a valid exercise of his "care and management" responsibility?

174. Yes: The proposed course of action would involve the Commissioner exercising his discretion as to the allocation of his resources recognised by the "care and management" responsibility in section 6A(2). In *Fleet Street Casuals* the House of Lords held that the United Kingdom "care and management" provision authorised the Revenue undertake a similar course of action. Before the Commissioner could undertake the proposed course of action, he would need to be satisfied that it is consistent with his obligations under section 6A(3) and section 6.

175. On the facts of this example, the Commissioner would balance the cost of auditing and assessing the industry members against the possible tax yield that might result if they were audited and assessed. He would also consider what resources he has available and the competing uses for those resources (section 6A(3)(a)). The Commissioner would have regard to the fact that auditing and reassessing would increase the industry members' compliance costs (section 6A(3)(c)). However, the Commissioner may give this factor little weight because any additional costs incurred as a result of audit and reassessment would be due to the industry members' non-compliance.

176. The Commissioner would evaluate the extent to which the proposed course of action would promote compliance, especially voluntary compliance (section 6A(3)(c)), and undermine or support the integrity of the tax system (section 6). Accordingly, the Commissioner would determine the benefits that might accrue from not auditing and reassessing the industry members, such as decreased levels of non-compliance in the particular industry. The Commissioner would balance the benefits against the risk that:

- complying taxpayers might consider it unfair if the industry members are not required to pay the full amount of tax; and
- that not reassessing and auditing the industry members might encourage non-compliance in other industries.

177. However, on the facts of this example, section 226B might apply. Section 226B was enacted to grant to the Commissioner a specific power to declare business group amnesties. It provides the Commissioner with discretion to "declare an amnesty … in relation to a group of persons, each of whom carries on a type of activity as the person's

main business". Section 226B also provides the requirements for a valid amnesty, including that the Commissioner must consider that declaring the amnesty is (section 226B(1)):

> ... consistent with—
>
> (a) protection of the integrity of the tax system; and
>
> (b) collection over time of the highest net revenue that is practicable within the law.

178. Accordingly, section 226B requires the Commissioner to take account of the same sorts of considerations as outlined in paragraphs 175–176 above. If section 226B does apply to the facts of this example, the Commissioner would declare a business group amnesty rather than undertake the proposed course of action under section 6A(2) and (3). This is because Parliament enacted section 226B for the specific purpose of addressing the situation outlined in the example. It is noted that section 226B imposes specific statutory restrictions on the Commissioner's ability to investigate, assess or reassess and prosecute persons covered by the business group amnesty (section 226B(8) and (9)).

Example 3: Deciding whether to audit where taxpayer discloses undeclared income

A taxpayer informs Inland Revenue that he has discovered an invoice representing income that he has inadvertently excluded from his tax return. The taxpayer wants Inland Revenue to agree not to audit the income year for which the return was filed, and states he will undertake to pay any tax liability and penalty resulting from the adjusted income amount immediately.

179. In this example the Commissioner could decide:

- to audit the taxpayer; or
- not to allocate the resources required to carry out the audit, and instead accept from the taxpayer the payment for the increased tax liability and any penalties incurred.

180. In determining which of the above options is consistent with section 6A(3) and section 6, the Commissioner would take account of the fact that accepting the taxpayer's payment would require fewer resources than would be required to carry out the audit (section 6A(3)(a)). This factor would need to be balanced against the risk that the excluded income indicates that the taxpayer has not been complying with his tax obligations and so could have other undeclared income. In considering this factor, the Commissioner would take account of the taxpayer's compliance history.

181. The Commissioner would also have regard to the likelihood that auditing would increase the taxpayer's compliance costs (section 6A(3)(c)). However, the Commissioner would give little weight to this factor. Taxpayers who file incorrect assessments should expect to incur additional compliance costs as a result of being audited and reassessed.

182. The Commissioner would have regard to the importance of promoting compliance, especially voluntary compliance, by all taxpayers (section 6A(3)(b)). The Commissioner might consider that auditing would promote compliance, because it will better ensure that the taxpayer has complied fully. On the other hand, the Commissioner could take the view that auditing would not promote voluntary compliance by taxpayers. This would be on the basis that the risk of being audited might discourage taxpayers from voluntarily disclosing to Inland Revenue inadvertently excluded income.

183. The Commissioner's decision whether or not to audit the taxpayer would need to be made after weighing up the above considerations.

Example 4: Use of the "care and management" responsibility instead of an existing statutory power

Can the care and management responsibility be used instead of an existing power? For example, if a taxpayer did not satisfy the definition of "serious hardship" in section 177A could the Commissioner write-off that taxpayer's outstanding tax on the basis of hardship under section 6A(2) and (3) rather than under section 177C?

184. No: The Commissioner can write off the debt on the basis of "serious hardship" only if this is authorised by section 177C. The debt cannot be written off under section 6A(2) and (3), even if the taxpayer argues that collecting the debt would cause hardship because, for instance, it would harm the taxpayer's business. In enacting section 177C, Parliament has specified precisely when such a write-off is to be permitted.

Example 5: Exercising statutory discretions

To be zero-rated under the Goods and Services Tax Act 1985, supplies of goods must be exported within 28 days. However, section 11(5) of the Goods and Services Tax Act 1985 provides that the "Commissioner may extend the 28-day period … if the Commissioner has determined, after the supplier has applied in writing" that either section 11(5)(a) or (b) are satisfied.

Taxpayers who regularly seek extensions have complained that the 28-day period is invariably too short and that making applications imposes significant administrative costs on them. They have asked the Commissioner to state that taxpayers who have in the past received extensions will not be required to make applications and can instead automatically zero-rate supplies that satisfy section 11(5)(a) or (b).

Can the Commissioner inform these taxpayers that they need not apply in writing to obtain extensions, but rather can automatically zero-rate supplies that satisfy section 11(5)(a) or (b)?

185. No: Section 6A(2) and (3) do not allow the Commissioner to exercise the powers and discretions contained elsewhere in the Inland Revenue Acts if he has not satisfied the requirements for their lawful exercise.
186. Section 11(5) provides the Commissioner with the discretion to extend the 28-day period if he considers that section 11(5)(a) or (b) is satisfied. This discretion can be exercised only after the taxpayer has made an application in writing. If the taxpayer has not made the application, the Commissioner cannot lawfully decide to extend the 28-day period or otherwise zero-rate supplies that have been exported after the 28-day period.
187. On the facts of this example, the Commissioner might consider recommending to the Government that the provision be amended to remove the written application requirement. He may consider this necessary in order to protect the integrity of the tax system.

Example 6: Issuing binding rulings

A taxpayer applies for the Commissioner to issue a private ruling under section 91E of the Tax Administration Act 1994. The Commissioner proceeds to draft the private ruling in accordance with his view of the correct interpretation of the relevant taxation law. Before the ruling is issued, the Supreme Court delivers a judgment on the relevant taxation law. As a result of the Supreme Court's decision, the Commissioner now considers the interpretation contained in the draft ruling to be incorrect.

The taxpayer considers the Commissioner's previous interpretation more commercially advantageous to it than the new correct interpretation. It asks the Commissioner not to redraft the ruling in light of the Supreme Court's decision and instead to issue the ruling immediately.

Could section 6A(2) and (3) authorise the Commissioner to issue a binding ruling other than in accordance with his view of the correct interpretation of the taxation laws?

188. No: Section 6A(2) and (3) do not allow the Commissioner to exercise the powers and discretions contained elsewhere in the Inland Revenue Acts if he has not satisfied the requirements for their lawful exercise. This means that section 6A(2) and (3) do not authorise the Commissioner to disregard the requirements and limitations on his ability to issue binding rulings contained elsewhere in the Inland Revenue Acts.
189. If the Commissioner were to issue binding rulings that did not reflect his view of the correct tax position, he would be invalidly exercising his authority to issue binding rulings. Section 91E confers on the Commissioner the authority to issue binding private rulings "on how a taxation law applies, or would apply to a person and to the arrangement … for which the ruling is sought". Section 91EH(1)(c) provides that a private ruling must state "[h]ow the taxation law applies to the arrangement and to the person". This means that the Commissioner must, at the time of issuing the ruling, consider that the ruling contains the correct interpretation of the relevant taxation law. In this example, the draft ruling contains the incorrect interpretation of the relevant taxation law. Accordingly if the draft ruling were to be issued without amendment, it would not be stating "how the taxation law applies to the arrangement and to the person".

Example 7: Altering taxpayers' obligations

Under section 79(1) of the Estate and Gift Duties Act 1968, a taxpayer is required to provide the Commissioner with a statement where he or she has made gifts in certain circumstances. Under section 79(2), a copy of a gift deed is also required where the gift is created or evidenced by a written instrument.

(a) Can the Commissioner decide not to refer to the deeds routinely?

(b) If the Commissioner decides not to refer to the deeds routinely, can he direct taxpayers not to send in the deeds?

190. In relation to issue (a): The Commissioner could decide not to refer to the deeds routinely if he considers that the resources required could be better used elsewhere to maximise the net revenue collected. This would involve the Commissioner's exercise of the managerial discretion as to the allocation and management of resources recognised by the "care and management" responsibility. Before the Commissioner could make this decision, he would need to determine that it would be consistent with section 6A(3) and section 6. To do this, the Commissioner would balance the costs of referring to the deeds routinely against the risk that incorrect assessments will be made if the deeds are not referred to routinely.

191. In relation to issue (b): The Commissioner could not direct taxpayers not to send in the deeds. Section 6A(2) and (3) do not authorise the Commissioner to purport to release taxpayers from the obligations imposed on them by the Inland Revenue Acts. Moreover directing taxpayers not to send in the deeds would be inconsistent with the Commissioner's obligation in section 6(1) to protect the integrity of the tax system, in particular with "the responsibilities of taxpayers to comply with the law" (section 6(2)(d)).

192. Consequently, on the facts of this example, one appropriate course of action would be for the Commissioner to reallocate resources so that he can deal with the deeds sent in. Alternatively, the Commissioner could consider recommending to the Government that section 79(1) be amended to no longer require the deeds to be sent in.

Example 8: Anticipated legislation change

A Bill before Parliament provides that all goods and services supplied by a particular industry will be zero-rated for GST purposes. Can the Commissioner decide not to pursue GST that has not been paid by taxpayers in that industry because he expects the Bill will be enacted?

193. Yes: The Commissioner could decide, at this point of time, not to allocate the resources required to pursue the unpaid GST that would not be owed if the Bill were enacted, on the basis that he considers that those resources could be better used elsewhere to maximise the net revenue collected. This would involve the Commissioner exercising his managerial discretion as to the allocation and management of his resources recognised by the "care and management" responsibility.

194. Before the Commissioner could decide not to pursue unpaid GST, he would need to determine that it would be consistent with section 6A(3) and section 6. If the Commissioner is satisfied that the legislative change will be retrospective (ie. the supplies made in the preceding three month period would qualify to be zero-rated), he might take the view that not pursuing the GST would decrease his collection costs. Not pursuing the GST would also minimise the taxpayers' compliance costs, because it would avoid the need for taxpayers to pay the GST and then seek to have it refunded after the Bill is enacted.

195. Under section 6, a decision not to pursue the GST owing might be viewed as inconsistent with the responsibilities of taxpayers to comply with the law (section 6(2)(d)) and the responsibilities of those administering the law to do so "according to law" (section 6(2)(f)). A decision not to pursue the GST owed would involve the Commissioner not enforcing the legislation, in force at that time, which imposes liability for GST. However, the Commissioner might consider that not pursuing the unpaid GST owing under the legislation in force at the time would amount to only a temporary and nominal failure to apply the law given he expects the Bill to be enacted with retrospective effect.

196. The Commissioner could not inform taxpayers that they are not obliged to pay the outstanding GST owing under the legislation in force. Similarly, the Commissioner could not advise taxpayers to assess themselves other than in accordance with the legislation in force. If the Commissioner were to do that, he would be purporting to alter taxpayers' obligations. Section 6A(2) and (3) do not authorise the Commissioner to do this.

Example 9: Relationship between section 6A(3) and the Commissioner's recovery obligations

Taxpayer A has a history of serious non-compliance, involving repeated failures to pay outstanding tax, comply with the Commissioner's information requests and to adhere to instalment arrangements. The Commissioner identifies two alternative courses of action for dealing with taxpayer A: he can enter into another instalment arrangement with her or, alternatively, bankrupt her and wind up her company.

Taxpayer A considers that another instalment arrangement is required by section 176(1). Section 176(1)

provides that "the Commissioner must maximise the recovery of outstanding tax from a taxpayer". Taxpayer A argues that an instalment arrangement would maximise the recovery of outstanding tax from her, because it means she can continue to operate her company and thereby generate sufficient income to pay the tax. In taxpayer A's view, bankrupting her and winding up her company would not maximise the recovery of outstanding tax, because she would no longer be earning any income.

The Commissioner takes into account taxpayer A's arguments, but also takes into account the fact that taxpayer A has failed to adhere to past instalment arrangements. The Commissioner considers that this fact indicates that taxpayer A cannot be relied on to adhere to another instalment arrangement, so it is dubious whether another instalment arrangement would recover any outstanding tax. In addition, the Commissioner considers which course of action is consistent with section 6A(3) and section 6. Having done this, the Commissioner concludes that he should bankrupt taxpayer A and wind up her company.

The taxpayer considers that the Commissioner has incorrectly applied the law. She argues that only section 176(1) is relevant and, accordingly, the Commissioner should not have considered section 6A(3) and section 6. Is the Commissioner required to consider section 6A(3) and section 6 along with section 176(1)?

197. Yes: The Commissioner has correctly applied the law. Under section 176(1) the Commissioner is obligated to maximise the recovery of outstanding tax from a taxpayer. To act consistently with section 176(1), the Commissioner must compare the amount that each course of action would likely recover from the taxpayer concerned.

198. In addition, the Commissioner must comply with section 6A(3) and section 6 when acting under section 176(1). Section 6A(3) applies in "collecting the taxes committed to the Commissioner's charge" and, therefore, when the Commissioner seeks to recover outstanding tax under section 176(1). Section 6 applies to all aspects of the Commissioner's administration of the tax system and must be complied with "at all times". Accordingly, the Commissioner must compare the available courses of action as to their consistency with his:
    - duty to collect over time the highest net revenue that is practicable and having regard to the three factors in section 6A(3); and
    - obligation to use best endeavours to protect the integrity of the tax system.

199. On the facts of this example, the Commissioner has concluded that bankrupting taxpayer A and winding up her company is more likely to maximise the recovery of outstanding tax from taxpayer A. Taxpayer A's history of serious non-compliance strongly suggests that she cannot be relied on to adhere to another instalment agreement.

200. Under section 6A(3), the Commissioner has taken into account that entering an instalment arrangement would preserve taxpayer A's ability to earn income. However, the Commissioner considers that bankrupting her and winding up her company are required to promote compliance, especially voluntary compliance, by all taxpayers (section 6A(3)(b)), and to protect the integrity of the tax system, particularly taxpayer perceptions of that integrity (section 6(2)(a)). Given taxpayer A's history of serious non-compliance, a failure to take firm action against her could reduce other taxpayers' expectations that they will be required to comply and, in turn, this could undermine the voluntary compliance system.

Example 10: Statutory prohibitions on the Commissioner

The Commissioner is satisfied that section 176(2)(b) applies to taxpayer B. Section 176(2)(b) provides that the "Commissioner may not recover outstanding tax to the extent that … recovery would place a taxpayer, being a natural person, in serious hardship". The term "serious hardship" is defined in section 177A. Can section 6A(3) and section 6 authorise the Commissioner to collect the outstanding tax despite section 176(2)(b)?

201. No: Section 176(2)(b) prohibits the Commissioner from recovering outstanding tax to the extent it would cause "serious hardship" to the taxpayer. Section 6A(2) and (3) do not authorise the Commissioner to disregard explicit legislative directions or prohibitions on how he may or may not act.

202. Section 6A(3) does not override section 176(2)(b) by virtue of the words "notwithstanding anything in the Inland Revenue Acts". There is no inconsistency between section 176(2)(b) and section 6A(3). Section 176(2)(b) does not require the Commissioner to collect all taxes regardless of the costs and resources involved. Consequently, section 6A(3) does not authorise the Commissioner to act inconsistently with section 176(2)(b).

Example 11: Unfair legislative outcomes

A legislative provision can be clearly interpreted and involves no ambiguity. When that provision is applied it has the perceived effect of taxing income twice. The principles of statutory interpretation do not permit the Commissioner to adopt an interpretation that would avoid this result. Can the Commissioner apply the provision in an alternative manner to avoid taxing income twice?

203. No: Section 6A(2) and (3) do not authorise the Commissioner to interpret or apply the legislative provision in a manner that is inconsistent with the statutory interpretation principles contained in the Interpretation Act 1999 and court decisions. If the legislation interpreted according to those statutory interpretation principles has the perceived or real effect of imposing double taxation, the Commissioner cannot assess the taxpayers on some other basis in order to avoid that effect: *Vestey v IRC*.

204. In this situation the Commissioner could recommend to the Government that the provision be amended in order to remove the double taxation effect. He may consider this necessary in order to protect the integrity of the tax system.

Example 12: Legislative anomalies

The Commissioner considers the original purpose and intent of a legislative provision is clear. However, based upon the ordinary (and unambiguous) meaning of its text, the provision's effect is inconsistent with what is thought to be its purpose and intent. Can the Commissioner depart from the ordinary meaning of the provision and instead apply it in a way that gives effect to its purpose and intent?

205. No: The Commissioner cannot decide that, because the provision results in anomalous outcomes or is otherwise unfair, he will interpret or apply the provision in a way that is not supported by statutory interpretation principles contained in the Interpretation Act 1999 and court decisions.

206. The Commissioner could recommend to the Government that the provision be amended. He may consider this necessary in order to protect the integrity of the tax system.

Example 13: Interpreting ambiguous legislation

Can care and management be used in determining the meaning to be applied to a provision that is ambiguous—such as where two constructions of a provision are open based upon the ordinary meaning of the words employed?

207. No: "Care and management" is not a "principle" to be used to resolve ambiguity in legislation. Legislation must be interpreted according to the statutory interpretation principles contained in the Interpretation Act 1999 and court decisions. However, this does not preclude reference being made to sections 6 and 6A to assist the interpretation in contexts where this would be normal under those principles: see for instance, *Westpac Banking Corp v CIR*; *Raynel v CIR*.

208. The Commissioner could recommend to the Government that the provision be amended in order to remove the ambiguity. He may consider this necessary in order to protect the integrity of the tax system.

Example 14: Unworkable legislation

Where the Act fails to provide a method to calculate the amount of tax in a particular circumstance, does the "care and management" responsibility authorise the Commissioner to "fill the gap" by supplying the calculation method?

209. No: The "care and management" responsibility does not authorise the Commissioner to remedy legislative errors and other deficiencies: *Vestey v IRC*; *R (on the application of Wilkinson) v IRC*; *NZ Film Services Ltd v CIR* (1984) 6 NZTC 62,062. The Commissioner must apply the law according to the statutory interpretation principles contained in the Interpretation Act 1999 and court decisions. The Commissioner can "bridge a hiatus" to make the legislation work as Parliament intended only to the extent he considers the courts would do so: see *Northland Milk Vendors Association Inc v Northern Milk Ltd* [1988] 1 NZLR 530.

210. The Commissioner would recommend to the Government that the provision be amended to provide the calculation method, because he would consider this necessary in order to protect the integrity of the tax system.

Example 15: Minor non-compliance by taxpayers

A non-resident company proposed to re-purchase and cancel a percentage of its shares. A statement is published in the Tax Information Bulletin states that, based on several assumptions, any payment received by shareholders will not constitute a "dividend" for New Zealand tax purposes. It is later discovered that a (minor) assumption has not been met. As a result, a significant percentage of the New Zealand shareholders may have derived a small dividend. The average amount of tax payable on any such dividend is likely to be less than one dollar and may be zero in some cases.

Can the Commissioner decide not to reassess the taxpayers to include any additional tax liability?

211. Yes: The Commissioner could decide not to allocate resources to reassessing the taxpayers if he considers that doing so would be consistent with section 6A(3) and section 6.

212. On the facts of this example, reassessing the taxpayers would result in the taxpayers' liability being determined according to law (section 6(2)(b)) and is consistent with taxpayers' responsibilities to comply with the law (section 6(2)(d)). Reassessing could promote compliance, especially voluntary compliance, by all taxpayers (section 6A(3)(b)). It might emphasise to taxpayers that they will be expected to comply fully, and encourage them to carefully follow the Commissioner's published items.

213. However, the costs that would be incurred (both by the Commissioner and the taxpayers) by reassessing are likely to be greater than the additional tax collected (section 6A(3)). Before the Commissioner could reassess the taxpayers, he would need to allocate resources to gathering information, answering taxpayer queries and reviewing taxpayer compliance. The Commissioner could take the view that reassessing would not significantly promote taxpayer compliance, given that the non-compliance here is due to the mistake of the company and not the taxpayers. The Commissioner could also take the view that, since the non-compliance is one-off, minor and inadvertent, he does not need to take firm action against the taxpayers so as to protect taxpayer perceptions of the integrity of the tax system (section 6(2)(a)).

214. Therefore, on the facts of the example, the Commissioner would likely consider that section 6A(3) and section 6 support him deciding not to allocate resources to reassessing. It should be noted that the taxpayers would still be liable for the unpaid tax even though they will not be reassessed at this point of time. Consequently, if the Commissioner were to audit and reassess any of the taxpayers at a later date, he potentially would be obligated to include the unpaid tax (subject to any statutory provision preventing this).

Example 16: Duty to maximise the net revenue collected

The Commissioner has audited HIJK Ltd, a large corporate taxpayer that employs several hundred New Zealanders. The audit indicates that HIJK Ltd's tax liability is greater than it has been assessed for in the last three income years. HIJK Ltd's representatives inform the Commissioner that if HIJK Ltd is required to pay this increased tax liability, it will no longer be competitive for it to operate in New Zealand and consequently it would move its operations offshore.

Can the Commissioner decide not to amend HIJK Ltd's assessment on the basis that it will "collect over time the highest net revenue" by ensuring that HIJK Ltd continues to operate in New Zealand?

215. No: The Commissioner would not be acting consistently with section 6A(3) and section 6 if he were to decide not to reassess HIJK Ltd so to ensure that it continues operating in New Zealand.

216. The duty to maximise the net revenue collected in section 6A(3) does not allow the Commissioner to forgo collecting the full amount of tax owing on the basis that doing so might encourage taxpayers to remain in New Zealand. Tax obligations are imposed directly on taxpayers by the Inland Revenue Acts. Accordingly only Parliament may address concerns that tax obligations are detrimental to New Zealand's economic activity.

217. On the facts of the example, not reassessing is inconsistent with "[t]he responsibilities of taxpayers to comply with the law" (section 6(2)(d)). If the Commissioner does not reassess, HIJK Ltd will not be required to discharge the tax liability Parliament has imposed on it. Not reassessing would undermine taxpayer perceptions of the integrity of the tax system (section 6(2)(a)) and would not promote compliance, especially voluntary compliance, by all taxpayers (section 6A(3)). Other taxpayers will consider it unfair that HIJK Ltd is not required to comply when they are required to do so. If the Commissioner were to not reassess, other corporate taxpayers might consider that they too could avoid their tax obligations by threatening to cease New Zealand operations.

Example 17: Treating taxpayers differently

An audit of four taxpayers in the same industry revealed that these taxpayers had assessed themselves on the basis of an incorrect interpretation of the law. Two of these taxpayers have been reassessed, with the result that their assessed tax liability has increased. Information suggests that the same issue is likely to be applicable to thousands of taxpayers in the same industry. The Commissioner has decided that these industry-wide taxpayers will not be audited at this time due to resource constraints. In addition, the industry as a whole has agreed to change its practices in future.

Can the Commissioner decide to:

(a) reverse the two reassessments; and

(b) not reassess the remaining two audited taxpayers?

Reassessed taxpayers

218. With respect to the two reassessed taxpayers, the Commissioner cannot amend the assessments to reflect the earlier incorrect interpretation of the law. If the Commissioner were to do so, he would not be validly amending the assessments under section 113. Section 113 provides that 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**" (emphasis added).

Audited, but not reassessed, taxpayers

219. While a final decision would depend on the facts of any particular case, the Commissioner could decide to reassess the audited taxpayers in circumstances such as these.

220. Reassessing the audited taxpayers would involve the Commissioner exercising the section 113 amendment power for the very purpose Parliament enacted it, that is, to ensure the **correctness** of the taxpayers' assessments. Reassessing the audited taxpayers would require few resources (section 6A(3)(a)). It would result in the taxpayers complying fully with their tax obligations (section 6(2)(b) and (d)) and, in turn, this would enhance their and other taxpayers' expectations that they will be required to comply with their obligations (section 6A(3)(b); section 6(2)(a)).

221. It is acknowledged that the audited taxpayers would need to rearrange their affairs once they are reassessed and, as a result, would incur additional compliance costs (section 6A(3)(c)). However, these additional compliance costs will be ultimately due to the audited taxpayers having adopted an incorrect legal interpretation. Consequently, in reaching his decision the Commissioner would give less weight to the compliance cost factor.

222. In this example, a decision not to reassess could be seen to potentially undermine the integrity of the tax system, on the basis that:

- the Commissioner would be accepting the audited taxpayers' assessments that he knows are incorrect, and this might compromise taxpayer perceptions of the integrity of the tax system (section 6(2)(a)) and not promote voluntary compliance by all taxpayers (section 6A(3)(b));
- the audited taxpayers would not be required to comply with their tax obligations (section 6(2)(b) and (d)); and
- the two reassessed taxpayers and other taxpayers might consider it unfair given they have been required to comply with their obligations (section 6(2)(a)).

223. The audited taxpayers may well consider it unfair that they are reassessed while the rest of the industry is not. However, the Commissioner would necessarily take into account the fact that tax obligations are imposed on taxpayers directly by Parliament and, accordingly, taxpayers should expect to comply with them, and that it is the Commissioner's role to collect those taxes: "[e] very ordinarily sophisticated taxpayer knows that the Revenue is a tax-collecting agency, not a tax-imposing authority" (*R v Board of Inland Revenue, ex parte MFK Underwriting Agencies Ltd* [1990] 1 All ER 91, 110) and that the Commissioner's "primary duty is to collect, not forgive, taxes" (*Preston v IRC* [1985] 2 All ER 327).

Example 18: Taxpayer reliance on incorrect Inland Revenue published item

The Inland Revenue booklet Qualifying Companies contained a statement that loss-attributing qualifying companies could elect to offset their losses against other group companies' income, before accounting for any remaining loss to the shareholders. This booklet was subsequently discovered to be incorrect and misleading. The Commissioner is aware that many taxpayers are likely to have relied on the booklet, so their self-assessments will be incorrect.

Some of the affected taxpayers have asked the Commissioner not to apply the current interpretation of the law to returns for years before the year in which the error was discovered.

224. It is important to note that the booklet is not a binding ruling, so the Commissioner is not legally bound to apply the interpretation it contains. Nevertheless, the Commissioner could decide not to allocate the resources required to identify, audit and reassess the taxpayers who relied on the booklet. However, before doing so, he would need to determine whether this course of action is consistent with section 6A(3) and section 6.

225. In making this determination, the Commissioner would take account of:

- the likely amount of the increased tax liability (section 6A(3)); and
- the resources required to identify, audit, and reassess the taxpayers, and the alternative uses for those resources (section 6A(3)(a)).

226. The Commissioner would also consider the risk that reassessing would be detrimental to taxpayers' confidence in relying on Inland Revenue publications. If this occurs it might result in increased numbers of incorrect assessments (section 6A(3)(b)). The Commissioner would also take account of the possibility that the taxpayers might consider it unfair that they are reassessed given they relied on the booklet and that they will incur additional compliance costs as a result. However, the Commissioner would weigh this consideration against the fact that he is not bound by the booklet (unlike binding rulings).

227. Under section 6, the Commissioner would take into account the following factors in favour of allocating resources required to reassess:

- reassessing would result in the taxpayers being required to comply with their obligations (section 6(2)(b) and (d));
- reassessing would enhance taxpayers' expectations that they will be required to comply fully (section 6(2)(a) and section 6A(3)(b)); and
- other taxpayers might consider it unfair if those taxpayers who relied on the booklet are not required to comply fully (section 6(2)(a)).

228. Whether resources are allocated to identifying, auditing, and reassessing the taxpayers who relied on the booklet would be made after the Commissioner has weighed up these factors.

229. If the Commissioner were to reassess the taxpayers, the taxpayers might be liable for use of money interest on the shortfall. The Commissioner would consider remitting this interest if authorised to do so by the relevant remission provision. (Under the Commissioner's current practice, he would remit use of money interest under section 183D where it is established that the taxpayer has relied on an incorrect statement by the Commissioner: see SPS 05/10 "Remission of penalties and interest", published in *Tax Information Bulletin* Vol 17, No 9 (November 2005)). The taxpayers would not be liable for a late payment penalty on the shortfall if they were to pay that tax by the new due date for payment fixed by the Commissioner.

[Note: It might also be necessary to consider the application of any specific provisions that relieve taxpayers from liability for interest or penalties in specified circumstances, such as where taxpayers have relied on Inland Revenue advice or publications.]

Example 19: Taxpayer reliance on incorrect Inland Revenue advice

A taxpayer rang an Inland Revenue call centre to ask whether a specific transaction was subject to GST. The call centre advised the taxpayer that the transaction was not subject to GST. The taxpayer based her assessment on this advice. Later, as a result of auditing the taxpayer, Inland Revenue becomes aware of the transaction and concluded that the taxpayer is required to pay GST on it. The taxpayer informs Inland Revenue of the advice she received from the call centre, and asks that she not be reassessed because she relied on this advice. Can the Commissioner decide not to reassess the taxpayer and instead accept her assessment?

230. On the facts of this example, the Commissioner would be likely to reassess the taxpayer.

231. Reassessing the taxpayer would involve the Commissioner exercising the section 113 amendment power for the purpose Parliament enacted it, that is, to ensure the **correctness** of the taxpayer's assessment. Reassessing the taxpayer would require few resources (section 6A(3)(a)). It would result in her complying fully with her tax obligations (section 6(2)(b) and (d)) and, in turn, this would help to enhance taxpayers' expectations that they will be required to comply with their obligations (section 6A(3)(b) and section 6(2)(a)).

232. By contrast, a decision not to reassess could be seen as likely to undermine the integrity of the tax system, on the basis that:

- the Commissioner would be accepting an assessment he knows to be incorrect, and this would compromise taxpayer perceptions of the integrity of the tax system (section 6(2)(a)) and not promote voluntary compliance by all taxpayers (section 6A(3)(b));
- the taxpayer would not be required to comply fully with her tax obligations (section 6(2)(b) and (d)); and
- other taxpayers might consider this decision to be unfair, given that they are required to comply with their obligations (section 6(2)(a)).

233. It is acknowledged that the taxpayer may consider it unfair that she is reassessed given that she relied on call centre advice, and that she will incur additional compliance costs as a result. There could also be a risk that reassessing her would result in other taxpayers becoming less confident in using Inland Revenue's call centres. If this occurs, it might result in increased numbers of incorrect self-assessments (section 6A(3)(b)). These considerations are important and the Commissioner would necessarily take them into account. However, the Commissioner could well take the view that they are outweighed by the following factors:

- Reassessing would result in the taxpayer complying with her tax obligations. The tax obligations are imposed directly on the taxpayer by Parliament and, accordingly, she should expect to comply with them.
- The call centre advice does not alter the taxpayer's legislative obligations. The Commissioner is not legally obliged to adhere to that advice (unlike binding rulings).

234. If the Commissioner were to reassess the taxpayer, the taxpayer might be liable for use of money interest on the shortfall. The Commissioner would consider remitting this interest if authorised to do so by the relevant remission provision. (Under the Commissioner's current practice, he would remit use of money interest under section 183D where it is established that the taxpayer has relied on incorrect Inland Revenue advice: see SPS 05/10 "Remission of penalties and interest", published in *Tax Information Bulletin* Vol 17, No 9 (November 2005)). The taxpayer would not be liable for a late payment penalty on the shortfall if she were to pay the shortfall by the new due date for payment fixed by the Commissioner.

[**Note:** It might also be necessary to consider the application of any specific provisions that relieve taxpayers from liability for interest or penalties in specified circumstances, such as where taxpayers have relied on Inland Revenue advice or publications.]

Example 20: Settling litigation

X Ltd proposes to Inland Revenue's Litigation Management Unit that a tax dispute set down for a court hearing be settled on the basis that X Ltd pays an agreed proportion of the tax claimed in the Commissioner's Notice of Proposed Adjustment. Would it be a valid exercise of the "care and management" responsibility for the Commissioner to settle on this basis?

235. Yes: The Commissioner could settle with the taxpayer if he considers that doing so is consistent with section 6A(3) and section 6. The courts have held that section 6A(2) and (3) authorise the Commissioner to settle tax disputes rather than undertake litigation.

236. In determining whether to settle, the Commissioner would have regard to the factors identified in paragraph 157 above, and any other relevant factors.

237. The Commissioner's decision whether to settle would also be made consistently with the Protocol between the Solicitor-General and Commissioner of Inland Revenue, dated 29 July 2009: see paragraph 160 above.

NEW LEGISLATION

TAXATION (ANNUAL RATES, TRANS-TASMAN SAVINGS PORTABILITY, KIWISAVER, AND REMEDIAL MATTERS) ACT 2010

The Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill was introduced into Parliament on 19 November 2009. It received its first reading on 8 December 2009, its second reading on 22 June 2010 and the third reading on 24 August 2010.

Several changes included in Supplementary Order Papers 105, 156 and 157 were made after the bill's introduction. They included measures to change the tax treatment of expenditure on films that receive a New Zealand screen production incentive, repeal the fund withdrawal tax, address the tax treatment of certain optional convertible notes, clarify RWT rates, introduce transitional arrangements for the GST rate and address "overreach" in the imputation credit rules.

The resulting Act received Royal assent on 7 September 2010. It amends the Income Tax Act 2007, Tax Administration Act 1994, KiwiSaver Act 2006, Goods and Services Tax Act 1985, the Estate and Gift Duties Act 1968, Income Tax Act 2004, Taxation (Budget Measures) Act 2010, Local Government Act 2002 and the Tax Administration (Binding Rulings) Regulations 1999.

TRANS-TASMAN PORTABILITY OF RETIREMENT SAVINGS

Sections 4, 59, 229 and Schedule 1 of the KiwiSaver Act 2006; sections CW 29, MK 8 and YA 1 of the Income Tax Act 2007

The KiwiSaver Act 2006 and the Income Tax Act 2007 have been amended to give effect to trans-Tasman portability of retirement savings. The portability arrangements will allow a person who has retirement savings in both Australia and New Zealand to consolidate them in one account in their current country of residence.

New Zealand and Australia need to exchange notes informing each other that the necessary legislation has been enacted before this facility can be utilised. The Australian legislation is expected to be enacted by next year. References below to "under Australian law" refer to the legislation that is expected to be enacted at that time.

Background

Retirement savings were unable to be transferred between Australia and New Zealand if a person resident in one permanently emigrated to the other.

The retirement savings portability arrangements were developed to improve the portability of retirement savings and remove an impediment to labour movement between New Zealand and Australia.

Key features

- Participation is voluntary for KiwiSaver members and scheme providers.
- Retirement savings may only be transferred between a KiwiSaver scheme and an Australian complying superannuation scheme regulated by the Australian Prudential Regulation Authority.
- A KiwiSaver member must permanently emigrate to Australia to be able to transfer their retirement savings.
- Any member tax credits and the $1,000 kick-start payment may be transferred to Australia.
- A KiwiSaver member will not be able to withdraw any retirement savings in cash upon permanent emigration to Australia, as can be done one year after the person emigrates to a country other than Australia.
- An amount of Australian-sourced retirement savings transferred to a KiwiSaver scheme under the portability arrangements will be treated as exempt from tax at the point of entry.
- Australian-sourced retirement savings will be subject to Australian complying scheme rules, including a minimum retirement age of 60. These savings will also not be able to be withdrawn to purchase a first home.

Detailed analysis

New rules for permanent emigration to Australia

A KiwiSaver member can transfer their retirement savings from their participating KiwiSaver scheme to an Australian complying superannuation scheme regulated by the Australian Prudential Regulation Authority. Members can request the transfer of their savings at any time after

they supply their provider with proof of their permanent emigration to Australia. The requirements for proof of permanent emigration to Australia will be the same as those contained in clause 14(3), schedule 1 of the KiwiSaver Act 2006.

KiwiSaver members transferring their retirement savings to Australia will also be able to transfer accumulated member tax credits and the $1,000 kick-start contribution. At present if a member withdraws their savings following permanent emigration from New Zealand they lose their member tax credits, as these are recovered by the Crown. That remains the position for permanent emigration to anywhere other than Australia.

The portability arrangements will apply only to transfers of retirement savings between New Zealand KiwiSaver schemes and Australian complying superannuation schemes. Members of complying superannuation schemes in New Zealand will not be eligible for the portability arrangements, but are covered by the existing rules for permanent emigration in clause 14.

The portability arrangements will be the only way for KiwiSaver members to take their accumulated savings with them when they permanently emigrate to Australia. Consequently, KiwiSaver members who emigrate to Australia will not be able to withdraw their accumulated savings in cash. This reflects the policy intent of KiwiSaver, which is to encourage a long-term savings habit and asset accumulation. The transfer is optional and members can choose to leave their funds in KiwiSaver. If members chose to leave their funds in KiwiSaver while residing in Australia, they will not be eligible to accumulate member tax credits.

Under Australian law, retirement savings transferred from KiwiSaver to Australia will remain locked in until the member reaches the age of entitlement to New Zealand Superannuation (currently 65).

Under Australian law, any New Zealand-sourced retirement savings that are transferred to Australia will not be able to be transferred from Australia to a third country.

Permanent emigration to countries other than Australia

For KiwiSaver members who permanently emigrate to a country other than Australia, the current rules in clause 14, schedule 1 of the KiwiSaver Act will continue to apply. These members may withdraw their accumulated savings in cash one year after their permanent emigration, except that the amount withdrawn will be reduced by the amount of Australian-sourced retirement savings (as well as any member tax credits), as provided by clause 14(1) and (2), schedule 1.

Differences for Australian-sourced retirement savings

Source-country rules

Differences between the Australian and New Zealand superannuation schemes mean that transferred savings will remain subject to a number of source-country rules. These rules will apply only to the principal amount of savings that are transferred from the original source country to the host country. Once transferred, earnings on those savings and any subsequent contributions will be subject to the rules of the host country.

Age of retirement

KiwiSaver members can completely withdraw their retirement savings on the later of five years of membership or on reaching the age of entitlement to New Zealand Superannuation (currently 65). Despite this, new clause 4B, schedule 1 will allow Australian-sourced retirement savings which are held in KiwiSaver to be withdrawn at age 60 if the member is retired.

The current Australian definition of retirement as defined in regulation 6.01(7) of the Superannuation Industry (Supervision) Regulations 1994 (Aust) is:

> The retirement of a person is taken to occur:
>
> (a) in the case of a person who has reached a preservation age that is less than 60 – if:
>
> (i) an arrangement under which the member was gainfully employed has come to an end; and
>
> (ii) the trustee is reasonably satisfied that the person intends never to again become gainfully employed, either on a full time or a part time basis; or
>
> (b) in the case of a person who has attained the age of 60 – an arrangement under which the member was gainfully employed has come to an end, and either of the following circumstances apply:
>
> (i) the person attained that age on or before the ending of the employment; or
>
> (ii) the trustee is reasonably satisfied that the person intends never to again become gainfully employed, either on a full time or a part time basis.

Member tax credits

To be eligible for member tax credits, members must reside mainly in New Zealand in the year for which the tax credit applies. As Australian-sourced savings relate to contributions made while the member was not residing in New Zealand, member tax credits will not be paid on such savings after they are transferred to KiwiSaver.

KiwiSaver housing-related initiatives

Australian-sourced savings held in KiwiSaver will not be able to be used for any of the KiwiSaver housing-related initiatives. The arrangement between the two countries prescribes that transferred savings cannot be withdrawn

to assist with the purchase of a first home. However, any earnings on Australian-sourced savings may be withdrawn for the purchase of a first home.

Membership invalidation

If a person's membership in KiwiSaver is invalidated after retirement savings are transferred from Australia to New Zealand, the principal value of any such savings will be returned to the member's Australian superannuation account.

In the rare situation where KiwiSaver account amounts must be transferred back to the original Australian complying scheme because the KiwiSaver enrolment is deemed invalid, an individual can nominate another superannuation scheme in Australia if their original scheme will not accept a transfer, or the scheme no longer exists. Once membership has been accepted by the Australian scheme, the KiwiSaver scheme provider will transfer the funds. These cases would most likely occur for those over 65, or non-New Zealand residents who have been invalidly enrolled in KiwiSaver; Inland Revenue expects the instances of this to be low.

Tax treatment of transfers

One of the principles of the portability arrangements is that transferring retirement savings across the Tasman should not lead to an unnecessary loss in value of those savings. To protect the value of retirement savings, such transfers between New Zealand and Australia will be exempt from entry or exit taxes.

Australia's excess non-concessional contributions tax

Transfers from KiwiSaver to an Australian superannuation scheme will be subject to the non-concessional contributions cap on initial entry into the Australian system. Australia imposes a tax-free limit (a "non-concessional contributions cap") of A$150,000 on the amount of superannuation contributions that an individual can make from non-wage sources in a particular year. Contributions that exceed this cap are taxed at a rate of 46.5 percent. This is intended to maintain the integrity of the Australian superannuation system. The cap will not apply to New Zealand-sourced or Australian-sourced superannuation contributions re-entering Australia.

Application date

The portability arrangements will come into effect up to two months after New Zealand and Australia have exchanged notes informing each other that the necessary legislation has been enacted.

KIWISAVER

ENROLMENT OF UNDER 18-YEAR-OLDS

Sections 4, 34 and 35 of the KiwiSaver Act 2006

Amendments have been made to provide clarity about who can enrol under 18-year-olds into KiwiSaver.

Background

The KiwiSaver Act 2006 provides that children under 18 years old are not subject to automatic enrolment, and can only opt into KiwiSaver by contracting directly with a provider. Previously there was a lack of clarity on who could contract with a scheme provider on behalf of a child under 18 years old.

A new set of rules provides clarity and certainty on the enrolment of under 18-year-olds in KiwiSaver. These rules provide that children under 16 years can be enrolled only by having all of their legal guardians contracting with a provider. Children aged 16 to 17 will be subject to a transitional rule, which recognises their growing intellectual maturity, by having them co-sign with one of their guardians. It is important that children of this age have some role in their enrolment and the consent process; furthermore, many young people begin working at this age.

Key features

Section 35 of the KiwiSaver Act prescribes how those aged under 18 can enrol in KiwiSaver. The new rules are explained below.

Children under 16 years old

Children under 16 years old may only be enrolled by their legal guardian(s), and may not enrol themselves in KiwiSaver.

Agreement and joint signatures will have to be obtained from all the child's guardians before they can be enrolled in a KiwiSaver scheme. This requirement is consistent with the Care of Children Act 2004, which states that a guardian of a child must act jointly with any other guardians of the child in exercising their duties and responsibilities.

It should be noted that if parents are separated, whatever the circumstances, both parents continue to be legal guardians unless a Court Order provides otherwise.

Children aged 16 or 17

Children aged 16 or 17 who have a legal guardian must co-sign with one of their legal guardians in order to enrol in KiwiSaver. They may not enrol themselves, nor will a legal guardian be able to enrol anyone aged 16 or 17 in KiwiSaver without their consent. One guardian's signature is sufficient, as the 16- or 17-year-old has to co-sign with their guardian to be enrolled.

Children aged 16 or 17 who do not have a legal guardian may opt into KiwiSaver by contracting directly with a scheme provider. This means that children aged 16 or 17 who are married, in a civil union or living with a de facto partner will not need a co-signatory in order to opt into KiwiSaver.

Detailed analysis

Providers must verify guardianship as at the date of enrolment of a child under 18 into KiwiSaver, and, if necessary, on the later exercise of membership-related discretions. For a provider to verify guardianship, or that a child aged 16 or 17 has no legal guardian, the following types of evidence may be used.

Children with a legal guardian(s)

The parents' names as listed on the child's birth certificate are sufficient evidence of guardianship.

If both parents are named on the birth certificate but one parent is deceased, the surviving parent will, in most cases, be the sole guardian. In this situation a written confirmation from the remaining parent confirming that they are the sole guardian will be considered to be sufficient evidence. This should also confirm that there are no other testamentary or court-appointed guardians.

Providers retain the discretion to require further documentation, including a copy of a parent's death certificate or will, if they wish to carry out further checks before choosing to accept a child under the age of 18 into their KiwiSaver scheme.

If consent to enrol a child is given by a legal guardian who is not a parent of the child, documentary proof of guardianship is required. The following original documents should be provided:

- a guardianship order issued by a New Zealand court;
- an additional guardian appointment form approved by a New Zealand court; or
- a copy of the parent's will appointing the person as a testamentary guardian together with the parent's death certificate.

A parenting order is not sufficient for this purpose. A step-parent is not, in a legal sense, a child's guardian unless appointed as a guardian through a court process or under a parent's will.

If the guardians are unable to provide this documentation then a signed statutory declaration from a guardian would be sufficient. Under section 9 of the Oaths and Declarations Act 1957 the persons authorised to take this statutory declaration are:

- a Justice of the Peace;
- a person enrolled as a barrister and solicitor of the High Court;
- a registered legal executive (fellow of the NZILE);
- a notary public;
- a registrar or deputy registrar of the High Court or a district court;
- the registrar or a deputy registrar of the Court of Appeal;
- the registrar or a deputy registrar of the Supreme Court;
- a member of Parliament;
- other government officer authorised to take statutory declarations.

Children without a legal guardian

For children aged 16 or 17 who are married or who have entered into a civil union, a copy of their licence will suffice. Alternatively, a statutory declaration for those married or in a civil union will be sufficient.

Exercise of membership-related discretions

Each provider will have their own internal guidelines on what authorisation signatories they will require for the exercise of membership-related discretions when a member who has contracted in is under 18, for example, a change of providers or a change of fund. Members should check with their own provider to find out what rules apply in their circumstances.

In general, for KiwiSaver members under 16 years of age, if a guardian acts as a signatory the signature of only one guardian will be sufficient. The Care of Children Act 2004 requires that, when practicable, all the guardians of a child must be consulted when making decisions about important matters affecting the child. The parent or guardian making the application for the child is responsible for consulting with the other parent or guardians of the child. It is not the responsibility of a provider to ensure that a guardian has consulted with other guardians in this way.

For KiwiSaver members aged 16 or 17, providers may chose to allow membership-related discretions to be exercised by the member, without requiring a guardian's joint signature.

If membership-related discretions are exercised by one of the guardians who initially enrolled a child under 18 into the scheme, providers will simply confirm that they are still the child's guardian. No further documentary checks are required.

However, a child may have a "new" guardian, that is, a guardian appointed since the child's enrolment into the scheme. If membership-related discretions are exercised by the new guardian then providers will need to obtain documentary evidence to confirm the status of that new guardian. This will be the same sort of evidence that is required to prove guardianship at enrolment, as listed above.

Application date

The new rules apply from the date of Royal assent, being 7 September 2010.

CONSISTENCY BETWEEN PAYE AND KIWISAVER RULES

Section 67 of the KiwiSaver Act 2006

Background

Previously there was inconsistency between the KiwiSaver rules and the PAYE rules for school children.

If a child has the tax credit for children under section LC 3 of the Income Tax Act 2007, Inland Revenue can reduce the amount of tax for a PAYE income payment. This can be done if the tax credit fully covers the child's PAYE liability, for example if their annual earnings are less than $2,340 (using 2010–11 rates).

Children who have validly opted into KiwiSaver and who are employed must have KiwiSaver deductions made from their wages. It is the policy intent that, if no tax deduction is required to be made from the payment of salary or wages at the time the payment is made, in accordance with the PAYE rules, then there is no requirement for KiwiSaver contributions to be made. However, section 67 of the KiwiSaver Act 2006 prevented this from happening.

Key features

Section 67 has been amended, confirming that children do not need to make regular contributions to KiwiSaver from their salary or wages if PAYE is not required to be deducted. A child may still choose to contribute to KiwiSaver by giving their employer a deduction notice.

Application date

The new rules apply from the date of Royal assent, being 7 September 2010.

PROVISION OF ANNUAL REPORTS

Section 122 of the KiwiSaver Act 2006

Background

Section 122 of the KiwiSaver Act 2006 (which incorporates section 17 of the Superannuation Schemes Act 1989) requires the trustees of a KiwiSaver scheme to provide an annual report to all KiwiSaver members in their scheme. If an email address is provided, the annual report can be delivered in an electronic format through an email attachment.

However, the annual report requirement could not be satisfied by providing a hyperlink to the report in an email, as a hyperlink provides a "point of access" to the information rather than providing the information itself.

Key feature

Section 122 of the KiwiSaver Act 2006 has been amended to allow scheme providers to satisfy the requirements to provide an annual report by sending a hyperlink in an email which links to the annual report, to any members who have agreed to this in writing.

Application date

The new rules apply from the date of Royal assent, being 7 September 2010.

LEASEHOLD ESTATE FOR FIRST HOME WITHDRAWAL

Clause 8, schedule 1 of the KiwiSaver Act 2006

Background

Clause 8, schedule 1 of the KiwiSaver Act 2006 allows members of KiwiSaver to withdraw their accumulated savings, less the one-off $1,000 kick-start Crown contribution and any member tax credits, to use for the purchase of a first home. A KiwiSaver member cannot withdraw their savings for a first home if they have previously held an estate in land, unless their financial position is what would be expected of a first home buyer.

Previously in clause 8, the definition of an estate included a "leasehold estate". A leasehold estate includes leasehold residential tenancies where a property owner rents the property to another party. Using that definition, a member who had ever been party to a rental lease agreement may not have been eligible for first home withdrawal.

Those people should not have been excluded from meeting the eligibility requirements for this reason only.

Key features

An amendment to clause 8, schedule 1 now ensures that individuals with an interest or past interest in a leasehold estate, such as a residential tenancy, are not excluded from first home withdrawal.

It also ensures that individuals with an interest in a leasehold estate may be eligible to receive the KiwiSaver deposit subsidy.

Application date

The amendment applies from 1 July 2010.

EMPLOYER EXEMPTION FROM AUTOMATIC ENROLMENT RULES

Sections 25, 29 and 30 of the KiwiSaver Act 2006

Amendments have been made to the exempt employer provisions to preserve exempt employer status in certain circumstances.

Background

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 introduced a provision to ensure that employers could not establish new schemes which are not KiwiSaver schemes for the apparent purpose of circumventing the automatic enrolment rules. It was considered that this behaviour undermined the policy intent of KiwiSaver and the rationale behind the exemption from the automatic enrolment rules. To overcome this concern, the exemption from automatic enrolment was closed to new employers.

However, that amendment was not flexible enough to take into account situations such as mergers and acquisitions, where exempt status would be lost due to the mere fact that the business merged with or was acquired by another body. In addition, exempt status would be lost if an employer moved schemes due to dissatisfaction with the current scheme provider.

These amendments address these concerns, by ensuring that exempt employer status is not automatically lost in certain situations, while still ensuring that employers cannot establish new schemes to circumvent the automatic enrolment rules.

Key features

Section 25 of the KiwiSaver Act describes the eligibility criteria the Government Actuary considers in granting an employer exempt status. In ensuring that no employers establish new schemes, the requirement that schemes must be registered by 7 October 2009 remains.

Section 29 describes how to apply to be an exempt employer. New section 29(1) states that a person may apply for approval of an employer (the current employer) to be an exempt employer if three conditions are met:

- an application (the old application) was received by the Government Actuary on or before 7 October 2009; and
- as a result of the Government Actuary's consideration of that application, an employer was approved as an exempt employer; and either:
  - the current employer changes schemes, that is, the current employer is the exempt employer;

    or
  - the current employer is a succeeding employer for that exempt employer due to a merger or acquisition (the successor provision).

This approach ensures that the Government Actuary is given the opportunity to consider new arrangements triggered by a merger or acquisition or an employer changing schemes to ensure that exempt employer status remains with employers that comply with sections 24 to 32.

For example, if a current exempt employer changes schemes, section 29 allows a person to make an application to the Government Actuary provided section 29(1) is complied with. Otherwise the employer's approval for exempt status granted under section 30 may not be operative, as the scheme for which the exemption was given has changed and no longer complies with the rules in section 25.

Equally, in situations of a merger or acquisition, where the employer may change, section 29 now allows a person to make an application, provided the conditions in section 29(1) are met. This process also ensures that exempt employer status remains with employers that comply with sections 24 to 32.

Application date

The amendments apply from 7 October 2009.

TEMPORARY EMPLOYMENT – REQUIREMENT TO MAKE KIWISAVER DEDUCTIONS

Section 22 of the KiwiSaver Act 2006

An amendment has been made to ensure that existing KiwiSaver members who begin temporary employment are able to give their employer a KiwiSaver notice requiring deductions of contributions to be made from salary or wages.

Background

Temporary employees, such as those employed for fewer than 28 continuous days, are not enrolled automatically in KiwiSaver. However, a temporary employee can opt-in to KiwiSaver either by giving their employer a KiwiSaver deduction notice or by contracting directly with a KiwiSaver scheme provider. The KiwiSaver deduction notice requires an employer to deduct KiwiSaver contributions from an employee's salary or wages. The requirement that an employer deduct an amount for the employee's KiwiSaver scheme also ensures that, as long as certain other criteria are met, compulsory employer contributions are made to the employee's KiwiSaver account.

If an individual is already a KiwiSaver member and begins temporary employment, they should be able to have KiwiSaver deductions made from their salary or wages and receive compulsory employer contributions. However, this was not previously allowed under the legislation.

Key feature

New subsection 22(3) has been inserted to allow an existing KiwiSaver member in temporary employment to give their employer a KiwiSaver deduction notice.

Application date

The new rules apply from the date of Royal assent, being 7 September 2010.

DISTRIBUTIONS TO CO-OPERATIVE COMPANY MEMBERS

Sections CD 2, CD 34B, DV 11 and YA 1 of the Income Tax Act 2007

The bill in effect extends the scope of sections DV 11 and CD 34 of the Income Tax Act 2007, which allow a co-operative company to deduct a distribution to a member if the distribution is in proportion to the sale and purchase of trading stock between the member and the co-operative. Amendments to section DV 11, and new section CD 34B, remove the requirement for strict proportionality by permitting a 20 percent differential. This flexibility is being introduced to reduce compliance costs for co-operative companies that pay dividends on a limited number of shares in excess of those held to match trading stock transactions.

Background

Previously, section DV 11 allowed a co-operative company to deduct a distribution to a member-shareholder if the distribution was one described in section CD 34. Such a distribution was required to:

- be made by a resident co-operative company that requires members to hold shares in proportion to their trading stock transactions with the company (say, one share for each kilogram of meat sold to the co-operative); and
- be in proportion to the member's supply of trading stock to the co-operative.

The distribution was taxable to the member under section CD 2.

Key features

- Section CD 34 has been repealed and replaced by section CD 34B, which is slightly broader in scope.
- Section CD 34B provides that a distribution by a co-operative company to a member on certain types of shares is not a dividend. This applies to shares held in proportion to actual or expected trading stock transactions between the member and the co-operative, and also to a limited number (20 percent) of other shares.
- Section CD 34B(9) provides an exception to section 125(2) of the Companies Act 1993 for co-operatives that elect deductible dividend treatment for tax purposes, and that provide a copy of the election to the Registrar of Companies. Subsection (9) gives such companies some flexibility in fixing the date of entitlement which establishes members' rights to receive dividends.
- Section DV 11, which currently provides for a co-operative company to deduct distributions to which section CD 34 applies, now refers to section CD 34B.

Detailed analysis

New section CD 34B applies to resident co-operative companies that pay dividends to resident members. It describes three types of shares—transaction shares, projected transactions shareholding and limited non-transaction shares. The distinction exists only for the purposes of tax rules relating to deductibility and dividends—the shares may be of the same or different classes for company law purposes.

Distributions in proportion to actual or estimated trading stock transactions

Under new section CD 34B, "transaction shares" are those that are held in proportion to trading stock transactions in a season. "Projected transactions shareholding" means shares held in proportion to estimated trading stock transactions in a season.

Distributions paid by a co-operative company on such shares are deductible to the co-operative (section DV 11) and are not a dividend to the member (new section CD 34B(2)(a) and (b)). However, they are taxable to the member (section CD 2).

Distributions on limited non-transaction shares

Non-transaction shares are shares that are not held in proportion to actual or estimated trading stock transactions but that nevertheless entitle the member to enter into trading transactions with the co-operative.

A distribution paid by a co-operative to a member on such a share is deductible to the co-operative, and is not a dividend to the member, if:

- the member holds only a limited number of such shares; and
- the constitution of the co-operative allows members to hold only a limited number of such shares.

The limit allowed under section CD 34B is the greater of 20 percent of the number of their transaction shares and 20 percent of their projected transactions shareholding.

If the constitution allows any member to hold more non-transaction shares than the 20 percent level, only distributions on transaction shares and projected transactions shareholding will be deductible to the co-operative and will not be a dividend. Distributions to any member on non-transaction shares will not be deductible.

Example

A is a member of a farmers' meat co-operative company. The company requires each member to hold one share for every 10 kgs of meat the member sells to the co-operative in a season. Members can also hold additional shares up to a maximum of 20 percent of shares held by the member to back their recent or estimated sale of meat to the co-operative. Shares held in excess of this are redeemed by the co-operative at the end of the season.

A estimates that he will supply 1,000 kg of meat in the 2010–11 season so he purchases 120 shares. He only supplies 800 kg of meat in the season. After the end of the season, in addition to the amount it pays the member for the meat, the co-operative company distributes $1 per share to members for that season so A receives $120. A holds 100 projected transactions shares (80 of which are transaction shares) and 20 limited non-transaction shares for the 2010–11 season. The distribution of $120 is not a dividend under new section CD 34B and is deductible to the co-operative under section DV 11. It is income to the farmer under section CD 2.

Variation

The co-operative company changes its constitution so that an individual member may hold any number of non-transaction shares. A estimates that he will supply 1,000kg of meat in the current season, and actually supplies 900kg. He holds 200 shares. The company pays a $200 dividend on the shares. A holds 100 projected transactions shares and 100 other shares. The $100 paid on the projected transaction shares is deductible to the co-operative and excluded as a dividend. The remaining $100 is non-deductible and may be a dividend.

In this case, section CD 34B(3)(b) also applies so that distributions on shares other than transaction shares or projected transactions shareholding held by any member (not just A) are not deductible and may be a dividend.

Review

As noted earlier, the government proposes to review the tax treatment of distributions from co-operative companies to shareholders later this year. This will enable full consultation on the appropriate treatment of such distributions.

Section 125(2) Companies Act 1993

A problem arises for co-operative companies with a particular capital structure that pay dividends to shareholders and have different financial years and trading seasons (for example, a trading year ending 31 March and a financial year ending 31 May).

Under section 125(2) of the Companies Act 1993, there is a maximum 20 working-day period between the time shareholders' entitlements to receive a dividend are determined (the "record date") and the date the company's board resolves to pay the dividend.

This creates a problem for co-operative companies that require shares to be held in proportion to trading stock transactions, pay dividends to shareholders and have a different financial year and trading season. If such companies pay a dividend in respect of a trading season after the end of the equivalent financial year, the record date can be in the new trading season. The appropriate record date should be in the trading season for which the dividend is paid.

Subsection CD 34B(9) therefore provides an exception to the 20 working-day rule, in relation to entitlements to receive distributions, for co-operative companies that have elected the tax treatment in section CD 34B. However, the exception applies in relation to all shares of the co-operative that entitle a member to enter into trading stock transactions. That is, the 20 percent limitation that applies for tax purposes does not apply for the purposes of the exception to the Companies Act 1993.

Example

A Co is a co-operative company whose members hold one share for each 10 kg of meat they supply to the co-operative. It has a trading season of 1 April to 31 March and a financial year of 1 June to 31 May. It intends to pay a dividend based on its 2010–11 trading season on 1 August 2011, after the end of its 2010–11 financial year. It wants to pay that dividend to members in relation to their shareholding in the 2010–11 trading season.

It elects under section CD 34B to deduct the dividends paid on its shares and also gives a copy of the election notice to the Registrar of Companies. It resolves to fix a record date for all future distributions of 31 March, being the last day of its trading season. As this resolution was made before the end of the 2010–11 trading season, the board can resolve to pay a dividend on 1 August 2011, in respect of the 2010–11 trading season, based on shareholding at 31 March.

Application date

The amendments will apply to distributions made on or after 1 April 2010.

CANCELLATION OF BETA DEBIT BALANCES RELATING TO CONDUIT RELIEF

The recently enacted Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010 restricts the use of debit balances in branch equivalent tax accounts to the extent that those balances arose from conduit tax relief. A taxpayer may elect to use debit balances to satisfy income tax liabilities that relate to attributed CFC income. However, the Act restricts use to cases in which the attributed CFC income arose in an income year beginning before 1 July 2009 and there is a timely election.

Background

Old international tax rules (BETA and conduit mechanisms)

Under the old international tax rules (replaced in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009), a New Zealand taxpayer with an interest in a controlled foreign company was subject to two potential taxing events: firstly, when income was earned by the foreign company (tax on attribution); and secondly, when that income was repatriated to New Zealand by way of a dividend (tax on dividends). The purpose of the branch equivalent tax account (BETA) mechanism was to relieve this double taxation and ensure that, overall, a single layer of New Zealand tax was imposed on that income.

Normally a New Zealand company paid tax on attribution before dividends were paid. In this case, the company received BETA credits that it could use to offset subsequent tax on dividends. In the rarer event that dividends were paid before tax on attribution, say because of an interim dividend, the company received BETA debits which it could use to reduce the subsequent tax on attribution.

The conduit tax relief regime sat alongside the rules for BETAs. Under the conduit regime, New Zealand companies with non-resident shareholders were able to claim "conduit relief" from tax on controlled foreign company income. This meant that, to the extent of the non-resident shareholding, no tax was payable on either attribution or on dividends. That is, not only was there no double taxation, but (to the extent of the non-resident shareholding) no taxation at all.

However, BETA debits and credits were still generated in respect of income and dividends that had been conduit-relieved – as if tax had been paid. Accordingly, if a dividend was paid before the income was attributed, conduit tax relief would be provided on the dividend and a BETA debit would also be created. The BETA debit would then be used to relieve any tax when the income was attributed. This was done to avoid double counting of the amount of conduit relief (recorded as conduit credits). Such double counting of conduit credits would have been unfair to taxpayers if the number of New Zealand shareholders increased and a repayment of a portion of the conduit relief was required.

Transition to new international tax rules

The transition to the new international tax rules required decisions about how to dismantle the various memorandum accounts, including the BETA credit and debit accounts and the conduit credit accounts.

In the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, the government introduced changes to the international tax rules that made BETA accounts for companies unnecessary in respect of foreign income that was earned under the new rules. In general, foreign dividends are now not taxable and so double taxation no longer occurs.

However, the government recognised there was a situation in which some double taxation could still occur if:

- repatriated funds had been subject to tax on dividends prior to the changes; and
- the income from which the funds were repatriated was subject to tax on attribution after the changes.

For this reason, the government announced that it would not cancel BETA debit balances for a period of two years.

Cancellation of some debit balances

It is apparent that the relief provided by non-cancellation of BETA debit balances is only required if tax was paid on the dividend that generated the BETA debits. If conduit tax relief was used to reduce or eliminate the tax liability, there is no possibility of double taxation and it is not appropriate to retain the BETA debits.

The Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010 therefore restricts the use of BETA debit balances to the extent that they arose from conduit tax relief on foreign dividends.

Key features

New sections OE 11B and OP 104B restrict the use of BETA debit balances that arise from conduit tax relief on foreign dividends.

The restriction is achieved by not allowing the relevant part of a BETA debit balance to be used to relieve tax on income attributed under the new international tax rules.

This approach allows taxpayers to continue, for a period of up to one income year, to use their BETA debit balances —whether or not resulting from the use of conduit tax relief—to offset tax that arose under the old international tax rules. The period of up to one income year is subject to restrictions to prevent manipulation of the new provision (essentially, to ensure the right amount of debits arising from both conduit-relieved and non-conduit-relieved dividends are used against pre-reform tax liabilities).

In contrast, outright cancellation of the relevant part of a BETA debit balance on entry into the new international tax rules would have resulted in simpler legislation, but would not have allowed continued use of debit balances against pre-reform tax liabilities. It was for this reason that outright cancellation was not pursued as an option.

Detailed analysis

Structure of cancellation rules (sections OE 11B and OP 104B)

If a company has a BETA debit balance on entry into the new international tax rules or at a later date, it must apply the restriction on use of BETA debit balances.

To apply the restriction, the company firstly identifies the individual BETA debits that make up the beta debit balance at a particular time. This is done with the aid of an ordering rule (subsection (3)).

Then, to the extent that the identified debits arose from the use of conduit tax relief to reduce an FDP (foreign dividend withholding payment) liability, they form part of the "CTR-relief amount" at that time (paragraph (1)(b)).

In general, the CTR-relief amount is not able to be applied to reduce tax on attributed foreign income. However, there is an exception (subsection (2)). For a defined period, the CTR-relief amount may be applied to reduce tax on attributed foreign income that arose *under the old international tax rules*. The exception is subject to limitations to prevent manipulation.

Rules for ordinary BETA accounts (section OE 11B)

Definition of affected year (subsection OE 11B(1))

An "affected year" is an income year in which the taxpayer applies the new international tax rules. The first "affected year" is the first income year beginning on or after 1 July 2009 (see the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009).

Definition of CTR-relief amount (subsection OE 11B(1))

Paragraph (b) defines the "CTR-relief amount". At any particular time, this amount is a portion of a debit balance that exists in the BETA account of a BETA company.

The CTR-relief amount is determined by identifying the BETA debits that have arisen to create the debit balance. This is determined with the aid of an ordering rule (see the explanation of subsection (3) below).

Once the BETA debits that created the debit balance have been identified, they are classified. To the extent that each debit arose from a conduit-relieved liability to pay FDP on a foreign dividend, it is part of the CTR-relief amount. Conversely, to the extent that each debit did not arise from a conduit-relieved liability, it is not part of the CTR-relief amount. Sections OE 12 and RG 7 (or the corresponding sections in the Income Tax Act 2004) are the sections that would have applied in the case of such a conduit-relieved liability. Note that sections OE 12 and RG 7 have since been repealed.

Example 1: Calculating the CTR-relief amount

NZCo, a standard balance date company which has always been 70% New Zealand owned, received foreign dividends on 30 September 2007, 21 May 2008 and 30 September 2009. FDP was payable on these dividends (liabilities of $1.2 million, $1.5 million and $0.7 million respectively). NZCo claimed conduit tax relief to the extent it was able and paid the rest of the FDP at the time dividends were received. NZCo had tax liabilities for attributed CFC income of $1.8 million in the 2007–08 income year, $0.5 million in the 2008–09 income year and $0.2 million in the 2009–10 income year. The company used all available debit balances to relieve tax on attributed foreign income. No foreign tax credits were available because no foreign tax was paid.

BETA account

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend		1.2m	−1.2m	1
21/5/08	Dividend		1.5m	−2.7m	2
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend		0.7m	−1.6m	3
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				
30/3/11	File tax return (attr. income)	0.2m		−0.9m	

On 1 April 2010, the debit balance included $0.4 million of debit number 2, being the remainder after application of BETA credits for use of BETA debit balances. The debit balance also includes $0.7 million of debit number 3. In each case, 30% of the debit arose from the application of conduit tax relief. Therefore, the CTR-relief amount on 1 April 2010 is $0.33 million (being 0.4 × 30% + 0.7 × 30%). On 31 March 2011, following another BETA credit, the CTR-relief amount is $0.27 million (0.2 × 30% + 0.7 × 30%).

Restrictions on use of CTR-relief amount (subsection OE 11B(2)).

A BETA company has historically been able to make an election to use all or part of a BETA debit balance to satisfy a liability for tax on attributed foreign income (subsection OE 7(3)).

Section OE 11B(2) restricts this election. The CTR-relief amount may not be used to satisfy a liability except in strictly defined circumstances, effectively reducing the available debit balance in all other cases to:

total debit balance – CTR-relief amount

More than "total debit balance – CTR-relief amount" may be used to satisfy a liability only if four conditions are met.

- The first condition is that all the conditions of section OE 7 are satisfied (this is implicit).
- The second condition is that the liability relates to attributed CFC income that arose under the old international tax rules. More precisely, the liability must relate to attributed CFC income that is allocated to an income year that begins before the first affected year (as defined in subsection (1)). Allocation of attributed CFC income to a particular year is determined according to the existing rules in subpart BD.
- The third condition is that when the election is made under OE 7, it must be made before any election under section OE 7 that is in respect of post-reform CFC income. More precisely, suppose that an election is made to use part of a BETA debit balance to offset the tax liability on attributed CFC income that is allocated to the first affected year, or to a later income year. Then, at or after the time of that election, it is not possible to make an election to use the CTR-relief amount.
- The fourth condition is that the election made under OE 7 must be made before the end of the first affected year.

The third and fourth conditions prevent manipulation of the rule. This is in response to a concern that by making elections out of order, a company could manipulate the CTR-relief amount. In normal circumstances (filing occurring on time, elections made at time of filing) these conditions are unlikely to be an obstacle.

Example 2: Use of the CTR-relief amount (all conditions met)

BETA account from Example 1.

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend		1.2m	−1.2m	1
21/5/08	Dividend		1.5m	−2.7m	2
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend		0.7m	−1.6m	3
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				
30/3/11	File tax return (attr. income)	0.2m		−0.9m	

The CTR-relief amount on 29/3/11 is $0.33m and the total debit balance is $1.1m. The company makes an election on 30/3/11 to use 0.2m of its BETA debit balance to offset the tax liability on attributed CFC income that it has allocated to the 2009–10 income year. The election is in respect of income that arose under the old international tax rules and is made before any election that is in respect of post-reform income. The election is also made just before the end of the first affected (2010–11 income) year. All conditions of (2) are met, so the election is permitted. It reduces the total debit balance to $0.9m and the CTR-relief amount to $0.27m.

For the 2010–11 income year, the company has a tax liability relating to attributed CFC income of $0.8m. It files an income tax return for the 2010–11 year on 29/3/12 and makes an election to use available debit balances to offset the $0.8m liability. Because the election is in respect of a tax liability on attributed CFC income that arose in a post-reform year, the condition in paragraph (2)(a) is not met and the company can elect to use only $0.63m of the BETA debit balance, being $0.9m – $0.27m. The remaining balance of $0.27m is no longer able to be used under section OE 7.

Date	Event	Credit	Debit	Balance	Debit number
29/3/12	File tax return (attr. income)	0.8m*		−0.1m	

* Made up of a $0.63m credit under section OE 7 and a $0.17m credit under section OE 6.

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The total debit balance is reduced to $0.1m. In terms of the ordering rule, this credit reduces the debits that did not arise from conduit relief first, then other debits. This means that the CTR-relief amount on 30/3/12 is $0.1m, the same as the total debit balance. It will not be possible to use any of the remaining debit balance by making an election under section OE 7.

Example 3: Use of the CTR-relief amount (condition of exception not met)

Recall Example 2, but suppose instead that the tax return for the 2009–10 year is not filed on 30/3/11, and no election is made to use the BETA debit balance to satisfy the 2009–10 attributed CFC income tax liability.

BETA account

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend		1.2m	−1.2m	1
21/5/08	Dividend		1.5m	−2.7m	2
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend		0.7m	−1.6m	3
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				

As at 30/9/11, the CTR-relief amount is $0.33m.

In the 2010–11 income year, the company has a tax liability for attributed CFC income of $0.8m. It files an income tax return for the 2010–11 year on 1/10/11 and makes an election to use available debit balances to offset the $0.8m liability. Because the election is in respect of a tax liability on attributed CFC income that arose in a post-reform year, the company can elect to use only $0.77m of the BETA debit balance, being $1.1m – $0.33m.

Date	Event	Credit	Debit	Balance	Debit number
1/10/11	File tax return (attr. income)	0.8m*		−0.3m	

* Made up of a $0.77m credit under section OE 7 and a $0.03m credit under section OE 6.

The total debit balance is reduced to $0.3m. In terms of the ordering rule, this credit reduces the debits that did not arise from conduit relief first, then other debits. This means that the CTR-relief amount on 30/3/12 is $0.3m, the same as the total debit balance.

On 2/10/11, the company finally files its tax return for the 2009–10 income year and recognises its $0.2 million of attributed foreign income. It is unable to elect to use any of the remaining BETA debit balance because it is made up entirely of the CTR-relief amount, and because:

- it has already made an election in respect of post-reform income (a day earlier); and
- it did not make the election before the end of the first affected year.

This violates both conditions in paragraph (2)(b).

Date	Event	Credit	Debit	Balance	Debit number
1/10/11	File tax return (attr. income)	0.2m*		−0.1m	

* A credit entirely under section OE 6.

Ordering rule for BETA accounts (subsection OE 11B(3))

The ordering rule is used to determine which of the BETA debits in the BETA account make up an overall debit balance.

The purposes of the rule are firstly to ensure that it is possible to identify the part of the overall debit balance that results from the application of conduit tax relief, and secondly to ensure that credits relating to post-reform income cancel out debits that have *not* arisen from conduit tax relief before other debits.

It is possible that a single debit could arise that results:

- partly from the application of section RG 7 to reduce the required payment of FDP; and
- partly from the actual payment of FDP, including a payment made under section RG 6 by reducing a loss.

Paragraph (a) requires that, for the purposes of applying the ordering rule, such a debit be split in two. One debit is equal to the reduction of FDP under section RG 7. The other is equal to the amount of actual FDP payment.

Paragraphs (b) and (c) then treat credits as cancelling out debits in two ways, depending on the type of credit.

1. For a BETA credit that arises before the first affected year, paragraph (b) requires in almost all cases that the credit reduces BETA debits in the order in which

the debits arise. When two debits arise at the same time and are not reduced to nil, they are reduced proportionately.

The paragraph (b) treatment also applies to a credit that arises on or after the first day of the first affected year, if:

- the credit arises as a result of an election under section OE 7; and
- the election is one that qualifies for the exception in subsection (2).

The paragraph (b) treatment does not apply to a credit that arises before the first affected year in one circumstance:

- the credit arose because of an election under section OE 7; and
- the election was made before the first affected year; and
- the election is in respect of post-reform attributed CFC income (so the condition in paragraph (2)(a) is not met).

It is doubtful that the legislation is intended to allow an election giving rise to such a credit. If it were possible for one to arise, is exceedingly unlikely to be seen in practice (if such an election does occur officials are likely to recommend a clarification to ensure it is ineffective). If one did nevertheless arise and was effective, it would use the treatment in paragraph (c).

Example 4: Ordering rule, paragraph (b) treatment debits before affected year

A standard balance date company has the following entries in its BETA account.

BETA account

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend		1.2m	−1.2m	1
21/5/08	Dividend		1.5m	−2.7m	2
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend		0.7m	−1.6m	3
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				

Each of the dividends was subject to FDP, which was reduced by 30% under section RG 7, with the remaining liability paid immediately.

The debit on 30/9/07 is treated as two debits. One is $0.36m, equal to the reduction under section RG 7, and the other is $0.84m, equal to the FDP actually paid. The debits on 21/5/08 and 30/9/09 are treated similarly.

The BETA account now looks like this.

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend (RG 7)		0.36m		1a
	Dividend (Other)		0.84m	−1.2m	1b
21/5/08	Dividend (RG 7)		0.45m		2a
	Dividend (Other)		1.05m	−2.7m	2b
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend (RG 7)		0.21m		3a
	Dividend (Other)		0.49m	−1.6m	3b
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				

The credit on 30/3/09 arises before the first affected year. It is the result of an election under section OE 7 and the election is in respect of pre-reform income (the condition in paragraph (2)(a) is met). Therefore, the credit is treated as described in paragraph (3)(b) and wipes out all debits in chronological order, with pro-rating for debits that arise simultaneously.

The credit is treated as reducing debits (1a) and (1b) to nil, then proportionately reducing debits (2a) and (2b) at the same time, to 0.27m and 0.63m respectively. The CTR-relief amount immediately after the reduction is 0.27m.

The credit on 28/3/10 is also treated as described in paragraph (3)(b). It further reduces debits (2a) and (2b) to 0.12m and 0.28m respectively. The CTR-relief amount immediately after the reduction, taking into account that debits (3a) and (3b) have also arisen, is 0.33m.

Example 5: Ordering rule, paragraph (b) treatment for credits arising in first affected year

The BETA account begins in the same way as Example 4.

BETA account

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend (RG 7)		0.36m		1a
	Dividend (Other)		0.84m	−1.2m	1b
21/5/08	Dividend (RG 7)		0.45m		2a
	Dividend (Other)		1.05m	−2.7m	2b
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend (RG 7)		0.21m		3a
	Dividend (Other)		0.49m	−1.6m	3b
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				

At the end of 28/3/10, the ordering rule treated 0.12m of debit (2a) and 0.28m of debit (2b) as remaining. If the income tax return for the 2009–10 year is filed on 30/3/11, and there are credits under OE 7 for 0.2m, the following entry occurs.

Date	Event	Credit	Debit	Balance	Debit number
30/3/11	File tax return (attr. income)	0.2m		−0.9m	

The credit on 30/3/11 arises after the beginning of the first affected income year, but the credit arises as a result of an election made under section OE 7 that qualifies for the exception in subsection (2). Therefore, the credit is treated as described in paragraph (b). The credit further reduces debit (2a) to 0.06m and debit (2b) to 0.14m. The CTR-relief amount after the credit is 0.27m.

2. All other BETA credits are treated by paragraph (3)(c) as:
   - firstly, reducing branch equivalent tax debits that did not arise from a reduction of an FDP liability under section RG 7, in the order they arose (with proportionate reduction of debits arising at the same time); and
   - secondly, to the extent that there is any remaining debit balance, reducing branch equivalent tax debits that did arise from a reduction of an FDP liability under section RG 7, in the order those debits arose (again, with proportionate reduction of debits arising at the same time).

Example 6: Ordering rule, paragraph (c) treatment for credit arising in affected year

The BETA account begins in the same way as Example 5.

BETA account

Date	Event	Credit	Debit	Balance	Debit number
1/4/07				0	
30/9/07	Dividend (RG 7)		0.36m		1a
	Dividend (Other)		0.84m	−1.2m	1b
21/5/08	Dividend (RG 7)		0.45m		2a
	Dividend (Other)		1.05m	−2.7m	2b
30/3/09	File tax return (attr. income)	1.8m		−0.9m	
30/9/09	Dividend (RG 7)		0.21m		3a
	Dividend (Other)		0.49m	−1.6m	3b
28/3/10	File tax return (attr. income)	0.5m		−1.1m	
1/4/10	ENTRY INTO NEW INTERNATIONAL TAX RULES				
30/3/11	File tax return (attr. income)	0.2m		−0.9m	

After 30/3/11, the ordering rule treated the remaining part of debit (2a) as being 0.06m and the remaining part of debit (2b) as being 0.14m.

If the income tax return for the 2010–11 income year was filed on 29/3/12, and there was a tax liability for attributed CFC income of 0.8m, the following entry would occur.

Date	Event	Credit	Debit	Balance	Debit number
30/3/11	File tax return (attr. income)	0.8m		−0.1m	

The credit arises after the entry into the new international tax rules. It does not arise from an election that qualifies for the exception under subsection (2), because it is in respect of post-reform income.

Therefore, the credit is treated under paragraph (c) as first reducing debits that did not arise from the application of section RG 7, the other debits. The credit wipes out the remaining 0.14m of debit (2b), wipes out debit (3b), wipes out the remaining 0.06m of debit (2a), and wipes out 0.11m of debit (3a), in that order. This leaves 0.1m of debit (3a) remaining. The CTR-relief amount, immediately after the application of the credit, is also 0.1m.

Rules for consolidated BETA accounts (section OP 104B)

Section OP 104B applies the same rules to consolidated BETA groups with BETA accounts that section OE 11B applies to BETA companies.

Application date

The new rules apply for all income years beginning on or after 1 July 2009. This was also the date of application of most provisions in the new international tax rules.

GIFT DUTY EXEMPTIONS

Section 73(2)(aa), 73(2)(jd), 73(2)(kb), 73(2)(o) of the Estate and Gift Duties Act 1968

Several new exemptions from gift duty have been added to the Estate and Gift Duties Act 1968.

Background

In general, gift duty is imposed on any gift of property in New Zealand, or outside New Zealand if the donor's permanent home is in New Zealand, or the donor is a company incorporated in New Zealand. A number of exemptions from gift duty are provided in section 73 of the Estate and Gift Duties Act 1968.

Key features

New section 73(2)(aa) of the Estate and Gift Duties Act 1968 exempts any gift required by an order of a court under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 from gift duty. The exemption ensures that the original policy intention that such distributions of property are exempt from gift duty is maintained.

New sections 73(2)(jd) and 73(2)(kb) exempt from gift duty any gifts made to central government and local authorities, provided these organisations are not carried on for the private pecuniary benefit of any individual. This exemption removes an impediment to donors who want to give property (monetary and non-monetary) to local or central government, and will reduce the associated compliance costs for those donors.

New section 73(2)(o) exempts from gift duty any gifts made to donee organisations. This exemption aligns the gift duty treatment of gifts made to donee organisations with the policy for encouraging greater giving to charitable and philanthropic causes.

Application dates

The exemption for distributions of property made in accordance with a Court Order under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 applies retrospectively to 24 May 1999, the date when Part 1 of the Estate and Gift Duties Act 1968 was repealed.

The other exemptions apply from the date of enactment.

BINDING RULINGS

QUESTIONS OF FACT

Sections 3(1), 91E(4)(a), 91E(4)(j), 91EF(3), 91EH(1B), 91EJ, 91F(4)(a), 91F(4)(h), 91FF(3), 91FH(1B) and 91FK of the Tax Administration Act 1994

Amendments have been made replacing the current general prohibition on determinations of fact with a provision that the Commissioner can rule only on the basis of the facts as provided by the applicant. The amendment clarifies that the Commissioner can rule on questions of tax avoidance and in doing so retain certainty for taxpayers.

Background

An underlying principle of the binding rulings legislation is that the Commissioner should not have to determine whether facts provided by an applicant for a ruling are correct. Previously under sections 91E(4)(a) and 91F(4)(a), the Commissioner was prohibited from ruling on questions of fact. On a literal interpretation of this provision it could be argued that the Commissioner was prohibited from making a ruling when doing so would expressly or implicitly require particular facts to be found to exist. In that case, the Commissioner would be unable to rule on fact-dependent issues such as the application of the general anti-avoidance provision or specific anti-avoidance provisions. Such a broad interpretation was, however, inconsistent with the understanding and application of the binding rulings provisions by taxpayers, tax practitioners and Inland Revenue since the binding rulings regime was introduced in 1994. The inability to obtain a binding ruling on questions of avoidance would have reduced certainty for businesses.

To ensure that the Commissioner can rule on tax avoidance, the relevant sections in the legislation have been replaced with a rule that the Commissioner cannot rule on "proscribed questions", including the existence or correctness of facts. The Commissioner can, however, rule on the basis of facts that are assumed to exist from the application for the ruling. Proscribed questions also include the taxpayer's intention, the value of anything and what constitutes commercially acceptable practice.

To remove any implication that the Commissioner is unable to rule on tax avoidance (which would defeat the main purpose of the proposed change) the exclusion for commercially acceptable practice is limited to where that term is used in the tax legislation.

Key features

- The rule that the Commissioner cannot rule on questions of fact (sections 91E(4)(a) and 91F(4)(a)) has been replaced with a rule that the Commissioner cannot rule on "proscribed questions", which include the existence or correctness of facts.
- Specific exclusions from ruling in relation to the taxpayer's intention, the value of anything and what constitutes "commercially acceptable practice" have been included as proscribed questions on the basis that they are likely to require the Commissioner to rule on the existence or correctness of facts.
- The Commissioner may make a ruling based on the facts provided by the applicant. The Commissioner may also enquire as to the correctness or existence of the facts provided by the applicant (for example, if there is an obvious factual error in the application), but is not required to do so.

Application date

The amendments apply from the day of Royal assent, being 7 September 2010.

ABILITY TO RULE WHEN THE MATTER IS SUBJECT TO A CASE BEFORE THE COURTS

Sections 91E(3)(b) and 91F(3)(b) of the Tax Administration Act 1994

The Commissioner's discretion not to rule on matters before the courts has been clarified by limiting its application to cases involving substantially similar arrangements. The amendment has clarified when the Commissioner will exercise the discretion.

Background

The Commissioner had a discretion under which he could decline to rule "if the matter on which the ruling is sought is subject to an objection, challenge or appeal, whether in relation to the applicant or to any other person". The provision was expressed in general terms and the scope of the provision, particularly the term "matter", was unclear. The provision did not allow for an unduly narrow interpretation such as requiring an identical transaction or the same (or associated) taxpayer. At the other extreme, it would have been inappropriate to apply the provision to all instances when an issue arose that was commonly determined in a transaction—for example, the application of the general anti-avoidance provision—as that would have allowed the Commissioner to turn down any ruling application on that issue. This lack of clarity did not give businesses certainty.

Key features

Sections 91E(3)(b) and 91F(3)(b) have been amended to clarify the Commissioner's discretion not to rule on matters which are the subject of a dispute with the applicant or another person. The application of the discretion has been limited to an arrangement on which the ruling is sought, or a separately identifiable part of that arrangement, which is substantially the same as an arrangement which is before the courts.

Application date

The amendments apply from the day of Royal assent, being 7 September 2010.

MASS MARKETED AND PUBLICLY PROMOTED SCHEME RULINGS

Sections 3(1), 91F(3)(bb), 91FC(1A), 91FD(1)(bb) and 141EC(1) of the Tax Administration Act 1994

An amendment has been made to allow promoters of arrangements, or those with an interest similar to that of a promoter, to apply for a product ruling for prospective arrangements. Previously a promoter could not request a binding ruling on an arrangement if the promoter was not a party to the arrangement. Allowing promoters of schemes to apply for product rulings could enhance overall tax compliance if such applications become standard practice.

Background

A product ruling sets out Inland Revenue's interpretation of how the tax law applies to an arrangement that is likely to be entered into with a number of people on identical terms. One of the conditions when applying for a product ruling was that the applicant must have intended to be a party to the proposed arrangement (section 91FC(1A)).

This meant the promoter of an arrangement could not generally apply for a product ruling. This position followed a legislative clarification in 1999 intended, among other things, to ensure that rulings applications were limited to "seriously contemplated" arrangements.

There are advantages to investors and promoters in Inland Revenue issuing binding rulings on schemes. Prospective investors can make their investment decision in full knowledge of the tax effects of the arrangement and this would assist with compliance with their tax obligations. The promoter of the scheme can use the binding ruling to market the scheme as a means of demonstrating that the scheme is sound from a tax perspective. For Inland Revenue there are also benefits in such rulings being made available. Inland Revenue will become aware of the arrangement at an early stage and administrative costs in auditing the scheme will be reduced.

Key features

New section 91FC(1A) of the Tax Administration Act 1994 allows promoters of arrangements to apply for product rulings for prospective arrangements.

To deal with the possible incentive for promoters of arrangements to omit relevant information or misrepresent the arrangement to obtain a favourable binding ruling, the promoter of the scheme is required to make a statutory declaration that the relevant facts and documents provided in the application are correct. The Commissioner has also been given a discretion not to rule if the promoter has previously applied for such a ruling and omitted relevant information or provided false information.

Application date

The amendments apply from the day of Royal assent, being 7 September 2010.

DECLINING TO RULE WHEN AN ARRANGEMENT IS THE SUBJECT OF A DISPUTE

Section 91E(4)(ga) of the Tax Administration Act 1994

Section 91E(4)(ga) has been clarified to allow the Commissioner to make a binding ruling if the arrangement is the subject of a dispute by way of notice of proposed adjustment (NOPA) but the application for the ruling relates to a different tax type from that in the NOPA. Previously the Commissioner could not make a ruling if the application related to an arrangement that was the subject of a NOPA. Allowing the Commissioner to make a ruling that relates to a different tax type to that being disputed enhances the usefulness of the rulings process.

Background

Before its amendment, section 91E(4)(ga) did not allow the Commissioner to make a private ruling if the application related to an arrangement that was being disputed by way of a NOPA. This criterion was added in 1999 to clarify the policy intent that there should be no overlap between the disputes resolution process and the binding rulings regime.

This meant that if a NOPA related to only one aspect of an arrangement, the Commissioner could not rule on other aspects which might not have been related to the issue being disputed. This could occur, for example, if an arrangement had both income tax consequences and GST consequences. Even if the NOPA related only to the GST aspects of the arrangement, the taxpayer could not obtain a ruling in relation to the income tax aspects of the arrangement.

Key features

Section 91E(4)(ga) has been amended to provide an exception to the prohibition on ruling on disputed arrangements that are the subject of a NOPA. The exception will apply if the application for the ruling relates to a different tax type from that being disputed.

A further requirement is that the matter in dispute, and that for which the ruling is sought, are sufficiently separate.

Application date

The amendment applies from the day of Royal assent, being 7 September 2010. When the bill was introduced, the amendment was to apply from the date of the bill's enactment. Following submissions, the application date was amended to apply to ruling applications which were already lodged but had not been declined or finalised before 7 September 2010.

A RULING WHICH FAILS IN PART

Sections 91EA(1), 91EB(1) and (2), 91FA(1) and 91FB(1) and (2) of the Tax Administration Act 1994

Amendments have been made to sections 91EB and 91FB so that a ruling can be made invalid in part rather than in full only. This is so that not all tax types are affected by the invalidity. The amendment is aimed at providing greater flexibility in the rulings process.

Background

Previously under section 91EB(2), a binding ruling which was based on facts or circumstances which were materially different from the arrangement actually undertaken was treated as fully invalid even if those differences were material only to certain aspects of the ruling. An example was when a ruling related to both GST and income tax and the material difference related only to GST.

Key features

Sections 91EB and 91FB have been amended to provide that if the invalidity of a ruling relates only to a certain tax type or types involved in the ruling, the other parts of the ruling relating to other tax types will continue to apply.

Application date

The amendments apply from the day of Royal assent, being 7 September 2010. When the bill was introduced, the amendment was to apply from the date of the bill's enactment. Following submissions, the application date was amended to apply to existing rulings.

PUBLICATION OF NOTIFICATION OF BINDING RULINGS IN THE *GAZETTE*

Sections 90(7), 90AD(1), 90A(7), 91AA(6), 91AAB(6), 91AAE(1), 91AAE(2), 91AAK, 91AAM(4), 91AAN(9), 91AAO(5)(a), 91AAQ(8), 91AAR(6), 91DA(2), 91DE(2), 91FH(4)(a) and (5)(a) and 91FJ(2) of the Tax Administration Act 1994

The requirement to publish the making and withdrawal of public and product rulings in the *Gazette* has been replaced with a requirement that the Commissioner publish the making and withdrawal of public and product rulings in a publication chosen by the Commissioner, such as the *Tax Information Bulletin* (TIB). Similar amendments have been made to the Commissioner's determination-making powers. The amendments are aimed at streamlining the process for making and withdrawing rulings and determinations.

Background

The binding rulings legislation required Inland Revenue to notify the making and withdrawal of public and product rulings in the *Gazette*. Public and product binding rulings were also published in full in Inland Revenue's TIB. The TIB is available on Inland Revenue's website and a paper copy can be requested. The TIB continues to be the main vehicle for publication.

Application date

The amendments apply from the day of Royal assent, being 7 September 2010.

UNACCEPTABLE TAX POSITION PENALTIES AND USE-OF-MONEY INTEREST

Sections 3(1), 120W and 141B(1D) of the Tax Administration Act 1994

New sections 120W and 141B(1D) have been added to ensure that taxpayers who rely on the Commissioner's official opinion will not be subject to use-of-money interest or to the unacceptable tax position penalty.

Background

A shortfall penalty for taking an unacceptable tax position can be imposed when a taxpayer's tax position fails to meet the standard of being "about as likely as not to be correct". The penalty applies when the tax position involves a significant amount of tax. Use-of-money interest imposed on a taxpayer is charged when tax is underpaid.

It was possible that an unacceptable tax position penalty and use-of-money interest could have applied if the

taxpayer had underpaid their tax as a result of relying on advice provided by Inland Revenue.

Key features

New sections 120W and 141B(1D) and a definition of "Commissioner's official opinion" ensure that taxpayers who rely on official Inland Revenue advice will not be subject to use-of-money interest or to the unacceptable tax position penalty as a result of their reliance.

The advice relied on will have to be:

- provided orally or in writing by the Commissioner as the official position of Inland Revenue and applicable specifically to the taxpayer (with all the relevant facts having been provided by the taxpayer); or
- a finalised official written statement of the Commissioner if it applies to the taxpayer's situation.

The amendments do not apply to private binding rulings. As these rulings are binding on the Commissioner, the taxpayer, in following the ruling, will not be subject to interest or the unacceptable tax position penalty.

The definition of "Commissioner's official opinion" was amended at select committee. The definition was broadened to include a finalised official written statement of the Commissioner if it applies to the taxpayer's situation

Application dates

The amendments apply to the Commissioner's official opinions given from the day of Royal assent, being 7 September 2010.

FEE WAIVERS FOR BINDING RULINGS AND GST ON NON-RESIDENT APPLICATIONS

Regulations 6 and 7 of the Tax Administration (Binding Rulings) Regulations 1999

The bill introduces a more flexible fee waiver provision and a reduction of the tax fraction for zero-rated supplies of binding rulings by amending the Tax Administration (Binding Rulings) Regulations 1999. The amendments allow such factors as the nature of the issue and the skill and experience applied by Inland Revenue staff in providing the rulings to be taken into account in charging for binding rulings. They also clarify the GST position on fees for non-resident applications.

Background

Private, product and status binding rulings all incur fees that are based on recovering the cost of providing the ruling. Previously, Inland Revenue could, in exceptional circumstances and at the Commissioner's discretion, waive all or part of any fee payable by an applicant. More flexibility was required for the exercise of the waiver. The waiver will now be based on what is fair and reasonable having regard to such factors as the nature of the issue and the skill and experience applied by Inland Revenue staff.

Key features

The Tax Administration (Binding Rulings) Regulations 1999 have been amended to provide for a more flexible fee-waiver provision based on what the Commissioner considers is fair and reasonable.

The fees for zero-rated supplies of binding rulings have been reduced by the tax fraction of the fee. Previously, the fee charged assumed a GST rate of 12.5% and did not take into account the fact that binding rulings issued to non-residents outside New Zealand could have been zero-rated under the Goods and Services Tax Act 1985. Therefore, any binding ruling issued to a New Zealand resident was in general cheaper than if that same ruling had been supplied to a non-resident. This was because the New Zealand resident, if registered for GST, could generally claim an input tax credit for the GST portion of the cost of acquiring the binding ruling. The non-resident, on the other hand, was unlikely to meet the requirements for registration or input tax credit entitlement.

Application date

The amendments will apply to new rulings made from the day of Royal assent, being 7 September 2010.

FURTHER CHANGES TO HELP BUSINESSES TRANSITION TO THE NEW GST RATE

Sections 78AA and 78B of the Goods and Services Act 1985; section 183AA of the Tax Administration Act 1994

Background

The Government has made a number of amendments as part of the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010, designed to further help businesses transition to the new GST rate of 15%. These amendments follow from recommendations made by the GST Advisory Panel. They supplement the transitional rules already provided in the GST Act, including those that were introduced in Budget night legislation and outlined in the August 2010 *Tax Information Bulletin* Vol. 22, No. 7. Further background on the GST rate increase is provided in that *Tax Information Bulletin*.

Detailed analysis

The amendments refer generically to the "rate change day" and the "original rate" (see section 78AA(1)) being, in the case of the recent GST rate increase to 15%, respectively 1 October 2010 and 12.5%. The explanation below primarily focuses on the impact of the amendments in relation to the 1 October 2010 increase.

Subrogation payments

A subrogation payment is the recovery income received by an insurer for the damages caused by a third party to their insured party. The GST Act deems the time of supply to be the day on which the insurer receives the payment. This would have meant subrogation payments received on or after 1 October 2010 would have been, in the absence of the transitional provision, subject to the 15% GST rate, even when the underlying claim to which the payment related was at 12.5%.

New sections 78AA(2) and (3) therefore allow the rate of GST to remain at 12.5% for subrogation payments received on or after 1 October 2010 to the extent that before 1 October 2010 the insurer has accepted the underlying claim and has paid the claim and/or agreed the recovered amount unconditionally.

Finance leases

In agreements to hire that are finance leases, GST is applied to the supply of the goods in question (a motor vehicle, for example) but not to the finance component of the transaction as financial services are GST-exempt. In such leases the interest and principal components may be calculated actuarially but, to ease compliance, GST can be accounted for on a straight-line approach over the term of the lease. This means that more GST is payable on the earlier lease payments than is actually required. A square-up adjustment is normally only done when the lease terminates, to reflect any difference between the actual and expected residual value of the leased asset.

With a rate change occurring during the contract term, and in the absence of the transitional provision, the new rate would have applied to the remaining payments under the finance lease contract. The subsequent reconciliation would have been complex, requiring systems changes to accommodate it. Most contracts are with GST-registered businesses who would be able to claim back the GST anyway.

New sections 78AA(4) and (5) allow certain finance leases to continue being accounted for at the 12.5% rate, if the lessor so elects. The lease agreements must be for a maximum term of five years and that term must have begun before 1 October 2010. A further requirement is that the lessor must advise GST-registered lessees within 30 days after the rate change day that their payments after the rate change day include GST at the original rate. This is intended to help ensure that lessees claim input tax at the 12.5% rate on such payments.

Only lease agreements for which part of the payment is consideration for the provision of credit under a credit contract, and for which that part payment decreases for each successive payment, qualify for the option.

Layby sales

For GST purposes, a layby sale (to which the Layby Sales Act 1971 applies) is recognised as taking place only when the goods are delivered, which is normally after the last instalment payment. Goods uplifted after 30 September 2010, therefore, would normally attract the new 15% GST rate.

Although payment of all of the layby instalments and collecting the layby item before 1 October would preserve the 12.5% GST rate, this may not always be possible because of the costs involved or the goods simply not being able to be delivered before that date. Transitional relief has therefore been provided.

New sections 78AA(6) and (7) apply to layby sales agreements made before the day on which the rate change was announced (20 May 2010). They allow suppliers to elect to apply the old 12.5% GST rate to any payments under the agreement that were received before 1 October

2010. Under this option, a supplier must account for these payments in their GST return that includes September 2010 as these payments are treated as a separate supply on 30 September. The balance of the agreement is treated as a further separate supply to which the normal layby time of supply rules apply, which means that the new 15% rate applies to payments made from 1 October 2010.

Aligning legislation and practice

There are several instances where further legislative flexibility has been needed so that GST practices adopted through systems or other commercial imperatives are not unduly affected by the rate increase.

The issuing of invoices dated on or before 30 September 2010

The first issue relates to goods or services for which an invoice is normally dated on or before the end of the month but for which an invoice may not be formally issued until early in the following month. Under the GST Act, it is the date when the invoice is issued that is relevant for determining the time of the supply, so in the absence of the transitional provision, invoices issued in early October 2010 but dated on or before 30 September 2010 could technically be considered to be subject to the higher rate.

Accordingly, for the GST rate transition, section 78AA(8) allows suppliers to treat invoices issued on or before 11 October 2010 as having been issued on the date of the invoice. This is provided that:

- the invoice is dated on or before 30 September; and
- the invoice is issued consistently with the supplier's practice of issuing invoices for such supplies; and
- payment for the supply is due no later than 60 days after the invoice date.

The cut-off date of 11 October was chosen to provide two weekends to send out such invoices.

Option of general time of supply or successive supplies rule

The second instance arises because some suppliers of what are arguably successive supplies account for GST when the invoice is issued rather than when payment is due or received. Under section 9(3)(a) of the GST Act, the GST rate on a successive supply involving goods under an agreement to hire or services provided under any agreement that involves periodic payment, should be determined by when the payment is due or received rather than when the invoice is issued.

As an example, telecommunications companies will usually bill for calls made (a service provided by the company), and a line rental fee (a charge for a successive supply of access to the company's telephone lines). Technically the calls could be subject to a different time of supply rule than the line rental so a company may take a pragmatic approach and treat the date of the issue of the invoice as the time of supply, even though this may have advanced the date of payment of the GST in respect of the line rental.

Under normal circumstances this would make no difference, but the rate change has generated some uncertainty about whether a September invoice, for example, would need to be charged at 12.5% or at 15% as this could be dependent on whether the customer paid or was required to pay before 1 October.

To address this issue, suppliers may choose to use the transitional option provided in sections 78AA(8) and (9) that enables the supply to be recognised on the date of the invoice if they meet the requirements of that option, even though section 9(3)(a) might otherwise apply.

Replacement invoices

The third issue concerns the use of replacement tax invoices. Under the GST legislation, a supplier cannot issue two tax invoices for the same supply and should instead issue credit or debit notes when, for example, goods are returned or additional GST is due as a result of the GST rate increase. For the GST rate transition period the following options are available.

- As an alternative to issuing a debit note, replacement tax invoices can be issued to replace pre-1 October 2010 invoiced supplies. This is envisaged to be primarily relevant to the case of successively supplied goods and services, to cover the amended GST payable on the remaining services provided from 1 October.
- There is an option of issuing a new invoice at the previous GST rate of 12.5% if it relates to revising an invoice issued before 1 October 2010, as an alternative to issuing a credit note. This is to ensure that the issuing of the replacement invoice instead of a credit note does not alter the applicable GST rate, as an invoice would alter the time of supply.

Certain contracts involving successive supplies

Many contracts, particularly in the general and health insurance area, are for a period of around one year or are at least reviewed annually. In some cases, the customer pays the premium in one upfront payment while in other cases it is paid progressively, say by monthly instalments. Most of these instalment arrangements straddle the GST rate change date of 1 October 2010 so that, in the absence of legislative change, some instalments would have been at the new GST rate and some at the old.

Businesses may be able to seek additional payment from customers to cover the additional GST, but in many cases the compliance cost to them of doing so would be excessive relative to the amounts of GST involved, particularly when the contract has very little time to run.

New sections 78AA(10) and (11) allow insurers and others the option of applying the 12.5% rate for the rest of the relevant period provided certain criteria are satisfied.

- The term of the agreement has to have commenced before 1 October 2010.
- The relevant period is determined by the period for which the consideration for a supply under the agreement is set or reviewed. The period cannot be more than 396 days and it must include 30 September 2010. In practice, in some cases this period will run to the end of the contract, while in others it will run to the next review date. The maximum period extends to 396 days (one year and one month) to cover a small number of general insurance policies that extend slightly beyond one year.
- The remaining GST has to be accounted for in the return period that includes 30 September 2010 as under the option this is the time of supply for the remaining supplies during the period. The supplier is also treated as issuing a tax invoice on that day. This will assist the recipient in claiming a deduction at that time if they return GST on an invoice basis, or need to make a section 78 transitional adjustment if returning GST on a payments basis.
- Within 30 days of the rate change day, the supplier is required to provide a GST-registered recipient with notice that payments by the recipient made after the rate change day include GST at the 12.5% rate. This will ensure that input tax is claimed at the 12.5% rate.
- If an insurance policy or other contract subject to the transitional rule is cancelled and, therefore the supply is not fully provided, businesses need to issue credit notes at 12.5% to adjust for the change in consideration and the GST incorrectly paid.

A business elects this option by making a tax return on this basis. The election need not cover all supplies. For example, an insurer may elect to include only certain types of insurance products.

Example

A policy for car insurance covers the period 28 April 2010 to 27 April 2011 and the customer chooses to pay by monthly instalments. The insurer normally pays GST when instalments are due or received but elects to apply the transitional rule and returns the remaining GST at 12.5% in its September GST return.

Insurance receipts

When a GST-registered party receives an insurance payout from their insurer in relation to a loss incurred in the course or furtherance of their taxable activity, they are required to account for GST on that payment. A deemed supply arises on the day the registered person receives the payment, under section 5(13) of the GST Act.

A payment may be made by the insurer in late September 2010 but be received by the insured party in October 2010. This would mean that the recipient has to pay GST at the rate of 15% on the payment, but because the payment by the insurer may only factor in GST at the old rate of 12.5%[1], the overall payment may not fully cover the loss.

New section 78AA(14) provides some leeway for payments in the pipeline. A payment under a contract of insurance received on or after 1 October 2010 is treated as being received on 30 September 2010 if the payment is made before 1 October 2010 and the registered person receives the payment on or before 11 October 2010.

The old 12.5% rate of GST therefore applies to payments received in these circumstances.

Private training establishments

Private training establishments (PTEs) are registered with the New Zealand Qualifications Authority (NZQA) and are required to use a trust arrangement when students pay their course fees in full. This is to help protect students from the risk that their intended course provider does not deliver the course. As the courses are delivered, the trustee progressively pays out the funds to the PTE.

In the absence of any law change, any payments released by the trust to the PTE after 1 October 2010 would be accounted for at the new 15% rate even if students paid the full course fees before 1 October 2010. This is because the services are considered to be supplied when the payments are released to the relevant PTEs. It would be impractical for the PTEs to seek additional payments from the students.

Accordingly, amendments to section 78B(2A) and a new section 78B(2B) allow a registered PTE the option of making an upfront adjustment in its GST return for September 2010 that would give it a credit to cover the additional GST

[1] The insurance company gets a input tax deduction at the old 12.5% rate, under section 20(3)(d).

payable when course fees held in trust as at 30 September 2010 are subsequently released to the PTE. This would apply irrespective of whether the PTE returned GST on an invoice, hybrid or payments basis.

The credit is based on the amount held in trust for the PTE as at 30 September 2010.

Extension of penalties and use-of-money interest remission

Budget legislation included an amendment to provide for automatic remission by Inland Revenue of the late payment and late filing penalties and use-of-money interest when:

- the lateness in filing or paying could be reasonably attributed to the change in the GST rate increase; and
- the registered person has made reasonable efforts to comply and, therefore, shortfall penalties such as lack of reasonable care, would not be applicable.

Initially, this relief, which is in section 183AA of the Tax Administration Act, applied only to return periods that included 1 October 2010 and, in some cases, later returns. For example, it covered returns that traverse 1 October 2010. GST return periods ending 30 September 2010 were, however, not covered.

Returns for periods ending 30 September 2010 can also be affected by the GST rate increase because in many cases they will include the section 78B adjustment that avoids the need, over the transition, for special time of supply rules when the GST-registered person is returning GST on a payments basis. Under the adjustment mechanism, all amounts that such registered persons pay or receive on or after 1 October 2010 are accounted for at the new rate but with an adjustment in the return covering 30 September 2010 to recognise the fact that the time of supply for some of the transactions would have been before the rate change day.

As GST returns for periods ending 30 September 2010 are due to be filed by 28 October, some may not, despite their best endeavours, be able to file the return by then, given the need to assemble the required information and calculate the adjustment. This is likely to be a particular issue for tax agents with many small business clients needing to calculate the transitional adjustment.

Accordingly, section 183AA has been extended to include returns ending on 30 September 2010 that include a section 78B transitional adjustment, on the same conditions as for other return periods that qualify – that is, the late filing or payment is reasonably attributable to the GST rate increase and the person has made reasonable efforts to comply.

Consequential change

Given that certain supplies can continue to be subject to a rate of 12.5%, a minor change has been made to section 78B(2A)(e) which relates to the transitional adjustment. The change ensures that such supplies are excluded from the adjustment when a recipient who could have made a section 78B adjustment in respect of those supplies, instead decides to account for the supply when the payment is made or received on or after 1 October at the rate of 12.5%.

Application date

The changes apply from the date of Royal assent, being 7 September 2010.

ANNUAL INCOME TAX RATES FOR 2010–11 TAX YEAR

The annual income tax rates for the 2010–11 tax year are the rates for that year specified in schedule 1 of the Income Tax Act 2007.

FIVE-YEAR EXTENSION OF EXEMPTION FOR NON-RESIDENT OFFSHORE DRILLING RIGS AND SEISMIC SHIPS

Section CW 57 of the Income Tax Act 2007

The exemption for income derived by a non-resident company from drilling exploratory or development wells and from undertaking seismic survey work in an offshore permit area has been extended to 31 December 2014.

Background

Prior to 2004, New Zealand's domestic tax rules taxed non-resident drilling rig operators and seismic ship operators from the first day of their presence in New Zealand. However, some of New Zealand's double tax agreements prevented New Zealand from taxing a non-resident rig or seismic ship operator if the period of presence in New Zealand was shorter than 183 days. If the ship or rig did stay for longer than 183 days, the non-resident was generally taxed from the first day of its presence in New Zealand.

Because of this rule, prior to an exemption being introduced in 2004, non-resident offshore rig operators and seismic vessels had tended to stay in New Zealand for a period of fewer than 183 days. Even if further exploration would be desirable beyond the 183 day window, there were strong incentives for rigs to leave by this time. Different rigs were then required to be brought to New Zealand to complete the work, causing extra mobilisation and demobilisation costs. This also disrupted sensible exploration and development programmes.

In order to remove this impediment the Government introduced a temporary exemption in 2004 which was due to expire on 31 December 2009. The exemption has now been extended until 31 December 2014.

Key features

The exemption applies to certain income of non-resident rig operators – specifically, income from the drilling of wells to explore or develop New Zealand's offshore permit areas. It also applies to the income of non-resident companies that operate ships providing seismic survey readings in these areas.

The exemption will apply until 31 December 2014.

Application date

To ensure that the exemption continues uninterrupted, the five-year extension came into force on 31 December 2009 (the date that the previous exemption was due to expire). This means that the exemption applies to income from drilling activities and seismic survey activities in an offshore permit area that is derived between the beginning of the company's 2005–06 income year and 31 December 2014.

CHARITABLE DONEE STATUS

Schedule 32 of the Income Tax Act 2007

Cure Kids is recognised as a charitable donee organisation from the 2010–11 tax year.

Individuals who donate to charitable donee organisations are entitled to a donations tax credit of 33⅓ percent of the amount they have donated, up to the level of their taxable income. Companies and Māori authorities that donate to charitable donee organisations are entitled to a deduction for donations up to the level of their net income. The maximum amount that may be claimed for donations to any qualifying organisation is set out on page 98 of *Tax Information Bulletin* Vol. 20, No. 3, April 2008.

Application date

The amendment applies from the 2010–11 and later income years.

EMISSIONS TRADING SCHEME ISSUES

EMISSIONS UNITS ALLOCATED TO OWNERS OF FISHING QUOTA

Sections CB 36 (10), CX 51C, DB 61, ED 1(5B)(db), YA 1

Background

The application of the Emissions Trading Scheme to liquid fossil fuels will increase the cost of diesel, which is one of the major costs in the fishing sector. Section 74 of the Climate Change Response Act 2002 provides for the allocation of emissions units to owners of fishing quota to compensate them for the fall in value of fishing quota expected to result from the impact of the increase in the cost of diesel.

Key features

The amendment in section CX 51C provides that when a person who owns fishing quota is allocated an emissions unit to compensate them for the fall in value of that fishing quota and then disposes of that unit, no taxable income arises. The provision does not apply if the person holds the fishing quota on revenue account.

Consequential amendments are made to sections CB 36(10), DB 61, and ED 1(5B).

Application date

The amendment applies from 1 July 2010.

ANTI-AVOIDANCE RULES

Section GC 3B

Background

Under the Income Tax Act, the disposal of certain items at a price below market value is deemed to take place at market value. This is to ensure that disposals for less than market value are not used as a mechanism to transfer wealth without appropriate tax consequences.

Prior to this amendment, the trading stock rules in section GC 1 were relied upon to apply a market value rule to emissions units. However, it was not certain that emissions units were trading stock for the purposes of this rule.

Key features

New section GC 3B states that section GC 1 applies to a disposal of emissions units as if the emissions unit were trading stock.

New GC 3B also preserves the exception formerly included in GC 1, which is that the rule does not apply to the surrender of an emissions unit.

Two further exceptions which relate to forestry rights and PFSI transfers are dealt with later in this TIB.

Application date

The amendment applies from 26 September 2008.

CONSEQUENCES OF TRANSFER OF EMISSIONS UNITS BETWEEN FORESTRY RIGHTS HOLDERS

Sections GC 3B and YA 1

Background

Forestry rights agreements are entered into between a landowner and another party, who will normally take responsibility for planting, maintaining and harvesting the forest. The forestry rights agreement will normally contain a clause under which revenue earned from the forest is shared between the parties. Forestry rights agreements are registered under the Forestry Rights Registration Act 1983.

The Climate Change Response Act 2002 allows only either the landowner or the holder of the forestry right to register to receive all of the units allocated for any particular piece of land. The party which receives all of the units will normally satisfy its obligations under the forestry rights agreement by transferring, without consideration, a proportion of the units to the other party.

Key features

Two separate amendments are made to ensure that:

- the special tax treatment accorded to forest land emissions units applies to a transferor who is a party to a forestry right; and
- a transfer of emissions units from one party to a forestry right to another does not trigger the anti-avoidance rule.

Detailed analysis

Special tax treatment accorded to forest land emissions units

The special tax treatment accorded to forest land emissions units is extended to the transferor under a forestry right by:

- new paragraph (b) of the definition of post-1989 forest land emissions unit; and
- new paragraph (c) of the definition of pre-1990 forest land emissions unit;

in section YA 1.

Anti-avoidance rule

As noted in the previous item, section GC 3B applies section GC 1 to transfers of emissions units, and potentially deems transfers at less than market value to have taken place at market value. Section GC 3B(2)(c) states that the market value transfer rule does not apply to a transfer between two parties to a forestry right, under a provision of that forestry right dealing with the allocation of income.

Application date

The amendment applies from 1 January 2009.

PERMANENT FOREST SINK INITIATIVE

Sections CB 36(4B), (6), DB 60(1), DB 60B(1), ED 1(5B), (5C), GC 3B and YA 1

Background

The Permanent Forest Sink Initiative (PFSI) is a government scheme under which foresters who enter into a covenant limiting their rights to fell their timber can receive emissions units from the government. These emissions units reflect the capture of carbon in the growing forests. If there is a loss of carbon in the forest beyond that permitted under the covenant, the forester is required to surrender emissions units back to the government.

Key features

These amendments make the tax treatment of the receipt of emissions units from government, and the surrender of emissions units to government, the same as the treatment of those transactions for post-1989 foresters under the emissions trading scheme (ETS). That treatment is that emissions units transferred by the government give rise to income and their surrender is deductible, both on a cash basis, consistent with the general tax treatment of forestry.

Detailed analysis

The general approach of the amendments is to provide legislation which parallels the existing legislation for post-1989 forestry under the ETS.

Section CB 36 is amended to deal with the surrender of emissions units to meet a liability under a PFSI covenant, and the surrender of an emissions unit awarded under PFSI to satisfy a liability which does not arise under either PFSI or post-1989 forestry.

Section DB 60 is amended to state that no deduction arises when a person is transferred an emissions unit under a PFSI covenant.

Section DB 60B is amended to state that no deduction arises when a liability to surrender emissions units arises under a PFSI covenant.

Section ED 1(5B) and (5C) are amended to include emissions units transferred under a PFSI covenant within the pooling rules.

New section GC 3B includes a provision that states that the market value transfer rule does not apply when a person transfers emissions units to the Crown under a PFSI covenant.

Section YA 1 includes a new definition of "forest sink emissions unit", and consequential changes are made to the definitions of "forest land emissions unit" and "replacement forest land emissions unit".

Application date

The amendment applies from 1 January 2009.

TRANSFERS TO INTERIM ENTITIES AS PART OF TREATY SETTLEMENT ARRANGEMENTS

Section YA 1

Background

A significant proportion of pre-1990 forestry land is currently held by the Crown. Inland Revenue understands that much of this land is expected to eventually be transferred to Māori under Treaty of Waitangi settlements.

The Climate Change Response Act 2002 (CCRA) includes a provision under which the relevant Minister can appoint a person to apply for emissions units in relation to that land. It is expected that that person will transfer those emissions units to Māori along with the relevant land when the Treaty settlements are implemented.

Emissions units allocated in relation to pre-1990 forestry land generally receive capital treatment. This is because this allocation is to compensate for the loss in the value of this land resulting from the introduction of the Emissions Trading Scheme. Prior to the amendment in this Act, capital treatment would apply only to the initial recipient of the units—once they left that person's hands they would normally have revenue account treatment, consistent with the fungible nature of emissions units.

However, that meant that the Māori persons or entities who eventually receive the emissions units from the person appointed by the Minister would have held those units on revenue account, and any gains made on disposal would be taxable. Revenue account treatment is not consistent with the underlying purpose and nature of these arrangements.

Key features

Legislation is amended to ensure that the Māori entity or person who receives a pre-1990 forest land emissions unit from the person appointed under section 73 of the CCRA also holds that unit on capital account.

The Income Tax Act provides capital treatment for emissions units defined in section YA 1 as "pre-1990 forest land emissions units". In its original form, a unit meets this definition only when the person who holds it received it from the government in relation to pre-1990 forest land.

New paragraph (b) of the definition of "pre-1990 forest land emissions unit" extends the meaning of that definition to include units that were received from the person originally allocated them, when the units have been transferred under section 73 of the CCRA.

Application date

The amendment applies from 1 April 2010.

ZERO-RATING OF CERTAIN TRANSFERS UNDER NEGOTIATED GREENHOUSE AGREEMENTS

Section 11A(1)(s) of the Goods and Services Tax Act 1985

Background

The Crown entered into Negotiated Greenhouse Agreements (NGAs) with two major greenhouse gas emitters in 2003 and 2005 respectively.

NGAs were entered into at a time when the introduction of a carbon tax was thought to be the most likely response to growing international concerns about greenhouse gas emissions. Businesses which signed an NGA agreed to move to world's best practice standards for emissions management in exchange for exemption from the proposed carbon tax.

The NGA participants have been exempted from obligations to surrender emissions units in relation to their emissions which would otherwise arise under the ETS, by Order in Council made under section 60 of the Climate Change Response Act 2002. However, side agreements are necessary to set out the mechanism for compensating these companies for the impact of the ETS on their input costs (such as the increase in their energy costs caused by their suppliers passing on the ETS costs they face).

The key element of these side agreements is the transfer of emissions units from the Crown to the companies to compensate them for the indirect costs of the ETS.

Key features

Legislation is amended to zero-rate the transfer of emissions units under a side agreement between the government and a party to an NGA.

Detailed analysis

Former section 11A(1)(s) and (v) essentially listed the transactions in emissions units which were zero-rated. These provisions have been replaced with a new section 11A(1)(s) which effectively states that all transactions in emissions units are zero-rated, with the exception of the two items listed in subparagraphs (i) and (ii).

The item listed in subparagraph (ii) leaves standard rating in place for those transfers which take place under the Negotiated Greenhouse Agreement itself (and one other transfer of emissions units under a historical arrangement), but this subparagraph does not apply to the transfers which take place under the side agreement.

Because of the interaction between section 11A(1)(s) and (u) and section 11(1)(o), this amendment has the unintended effect of extending the zero-rating of the contra supply of goods and services made in exchange for a supply of emissions units. This issue, and the proposed correction of it, is explained in detail in the item on **www.taxpolicy.ird.govt.nz** dated 1 October 2010.

Application date

The amendment applies from 1 July 2010.

REPEAL OF FUND WITHDRAWAL TAX

Subpart CS, sections CX 10(2)(c), HM 37(3), RD 72, and YA 1 of the Income Tax Act 2007; sections 32, 32C and 165AA of the Tax Administration Act 1994; and section 4 of the Taxation (Budget Measures) Act 2010

As a consequence of the alignment of the top ESCT rate and the top personal tax rate at 33% in Budget 2010, fund withdrawal tax (FWT) was to be phased out so that it would not apply to contributions made after 1 October 2010.

However, FWT has instead been repealed for all withdrawals from 1 April 2011, which is the date from which there is no discrepancy between the top ESCT rate and the top actual tax rate.

Background

FWT is a tax of between 4.2% and 5% payable on certain superannuation fund withdrawals that relate to employer contributions for members whose income is above $70,000. FWT was introduced to ensure that employees who are on the highest tax rate (38% until 1 October 2010) are not under-taxed under the employer superannuation contribution tax (ESCT) rules, as the top rate for ESCT was 33%.

Without FWT it would have been possible for a person on the 38% tax rate to "salary sacrifice" by agreeing with their employer to pay a contribution to a superannuation fund instead of salary. This contribution would have been taxed at a final rate of 33%. If the person later withdrew the employer contribution from the fund there would have been no further tax on the withdrawal. As not all superannuation funds require that members' funds are "locked" in the fund until retirement, this would have provided a mechanism for people on 38% to have salary and wages taxed at 33% rather than 38%.

The Taxation (Budget Measures) Act 2010 reduced the top marginal PAYE rate of 38% to 33% from 1 October 2010. This means that from 1 October 2010 there will be no discrepancy between the top ESCT rate and the top marginal PAYE rate (which is the final rate that applies for non-filing individuals). From 1 April 2011, there will be no discrepancy between the top ESCT rate and the top personal tax rate (which is the final rate that applies for individuals who file returns). As a result, there will no longer be a need for FWT.

Rather than repealing FWT outright, the Taxation (Budget Measures) Act 2010 had preserved FWT for contributions made before 1 October 2010 and then phased it out after five years. The rationale was that repealing FWT carries a theoretical risk of salary sacrifice in the period after the Budget but before marginal tax rates are aligned with ESCT.

Key features

Subpart CS has been repealed from 1 April 2011. This means that FWT will not apply to withdrawals after this date.

If a withdrawal is made before 1 April 2011, funds will need to return income that relates to the 2010–11 or earlier income year according to section CS 1(8), notwithstanding that subpart CS is repealed from 1 April 2011. For example, if a withdrawal to which section CS 1 applies is made on 1 August 2010 (during the fund's 2010–11 income year), the fund will need to include an amount calculated under section CS 1 in their income for the 2011–12 income year.

A number of consequential repeals have been made in the Income Tax Act 2007 and the Tax Administration Act 1994 to reflect the repeal of FWT.

- Section CX 10(2)(c) of the Income Tax Act 2007, which provided that a loan made by a superannuation fund is not a fringe benefit if it falls under the FWT rules.
- Section HM 37(3) of the Income Tax Act 2007, which provided that income derived under FWT rules by a multi-rate PIE is treated as income to which no investor has an investor interest.
- Section RD 72 of the Income Tax Act 2007, which provided that a trustee may recover FWT from member's distribution.
- Section YA 1 of the Income Tax Act 2007, which defined:
  - "member" (paragraph (b))
  - "withdrawal"
  - "significant financial hardship"
  - "trust rules" (paragraph (a))
- Section 32B of the Tax Administration Act 1994, which provided that a superannuation fund can request information from a member or member's employer in respect of FWT.
- Section 32C of the Tax Administration Act 1994, which provided that a superannuation fund can request information from a transferor super fund in respect of FWT.
- Section 165AA of the Tax Administration Act 1994, which provided that a superannuation fund may recover FWT from a member's distribution.

Under section 4 of the Taxation (Budget Measures) Act 2010, funds would have been required to track contributions made before and after 1 October 2010 until FWT was eventually phased out after five years. This provision has been repealed from 7 September 2010.

Application dates

Amendments to repeal FWT apply from 1 April 2011.

Section 4 of the Taxation (Budget Measures) Act 2010 has been repealed from 7 September 2010, which is the date that the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010 received Royal assent.

RWT WITHHOLDING CERTIFICATES AND RECONCILIATION STATEMENTS

Sections 3(1), 25(6) and 51(2)(g) of the Tax Administration Act 1994

Financial institutions are required to include various types of information on RWT (resident withholding tax) withholding certificates and reconciliation statements. This includes the tax rate that was applied to the interest, the amount of interest paid and the amount of RWT withheld. Requiring this information to be included on the certificate makes it easier for taxpayers who receive interest income to determine whether they need to file a return or request a personal tax summary, and whether they are using an appropriate RWT rate for their circumstances.

In providing the tax rate that was applied to the interest, financial institutions are permitted to show the average of the tax rates used during the year. However, financial institutions calculate this in different ways. Some financial institutions may have difficulties calculating the tax rate that was applied to the interest for the 2010–11 tax year, given that RWT rates were reduced from 1 October 2010.

Key features

The requirements for RWT withholding certificates and reconciliation statements have been made more flexible. Some drafting clarifications to the requirements have also been made.

Section 25(6)(d) of the Tax Administration Act 1994 has been amended to remove the requirement that the basic tax rate applied to the interest be shown on the RWT certificate. Financial institutions must continue to include the amount of interest paid and the amount of RWT withheld.

The requirement in section 25(6)(d) has been replaced with a provision that requires interest RWT certificates to include one or more of the following:

1. the average rate that applied;
2. the marginal rate that would have applied had the interest been paid at the end of the relevant tax year;
3. the rate at which RWT was withheld during the year. In this case, if more than one RWT rate was applied during the year, the certificate should show the amount of interest to which each rate applied and the amount of RWT withheld at each rate.

A new definition of "RWT rate" has been added to section 3(1). This clarifies that the rate referred to in the requirements is the RWT rate for interest income.

The punctuation in subsections 25(6)(a), (b), (c) and (d) has also been corrected. This amendment clarifies that each of the requirements in those subsections must be met.

Section 51(2)(g) required RWT withholding reconciliation statements to include the basic tax rate for RWT that applied to the resident passive income. This requirement has been removed.

Application dates

These amendments apply for RWT withholding certificates and reconciliation statements relating to the 2010–11 tax year and future tax years.

FACILITATION OF BUDGET 2010 PIE TAX RATE CHANGES

Sections HM 42B, HM 58 and HM 60 of the Income Tax Act 2007

Background

To coincide with the personal tax cuts announced in the 2010 Budget, the tax rates that apply to portfolio investment entity (PIE) investments (known as prescribed investor rates or PIRs) are being reduced from 1 October 2010. The Taxation (Budget Measures) Act contained some provisions to facilitate this change in rate, including a transitional method for applying the new rates.

This Act contains an alternative transitional method, designed to reduce compliance costs for some PIEs, and also some remedial amendments to the changes introduced in the Budget Act.

Key features

Alternative part-year calculation method

- An exit PIE can elect to treat the 2010–11 tax year as if it were two tax years, split by 1 October. A PIE that elects this option calculates its tax liabilities based on existing PIRs until 30 September, and based on the post-Budget PIRs from 1 October onwards.
- PIEs that elect this method will generally have to file returns and pay tax for both part-years.
- Foreign tax credits that are attributable to the first part-year ending on 30 September can be carried over to the second part-year.

Detailed analysis

Alternative part-year calculation method ("hard close" option) (section HM 42B)

The Act introduces new section HM 42B, which provides that for the 2010–11 tax year, PIEs to which section HM 42 applies (exit PIEs) can elect to treat the year as two separate tax years, split by 1 October 2010. A PIE makes such an election by filing its returns under sections 57B(5) or (7) of the Tax Administration Act 1994 (TAA) as described below.

If a PIE is not an exit PIE, or it does not make an election to use this transitional method, it must apply the 1 October PIR changes as set out in HM 60(3).

Effect of calculation method

A PIE that elects this option calculates its investors' tax liabilities using existing PIRs (12.5%, 21%, 30%) for the first part-year (1 April to 30 September). The PIE then calculates its investors' tax liabilities for the second part-year (1 October to 31 March) using the post-Budget PIRs (10.5%, 17.5%, 28%).

If an investor notifies an electing PIE of a new PIR after 1 October, that PIR is only applied to income attributed to the second part-year. The investor's tax liability for the first part-year remains unchanged.

Requirements for returns and tax payments

Section HM 42B(3) provides that an electing PIE must generally file tax returns and pay any resulting tax at the end of both part-years. However, a PIE can choose to send account summaries to its investors and certain information to the Commissioner of Inland Revenue, as required by sections 31C(4) and 57B(7) of the TAA respectively, separately for each part-year, or in a single consolidated form.

Treatment of foreign tax credits

Section HM 42B(4) sets out that foreign tax credits are not extinguished by the end of the first part-year. Specifically, despite the deemed tax year-end on 30 September, foreign tax credits (credits under subpart LJ) that are attributable to the first part-year can be carried over and used in the second part-year.

Credits attributable to the second part-year cannot be used to offset tax liabilities in the first part-year, as those liabilities are crystallised when the PIE performs its end-of-year tax calculation on 30 September.

Transition of rate for certain investors (section HM 58)

Section HM 58 is designed to automatically change investors' notified investor rates to reflect the new PIRs that take effect from 1 October 2010.

The Act introduces a remedial amendment to this section, so that investors with a notified investor rate of 19.5% are also transferred to the appropriate new rate, 17.5%, on 1 October. This change is necessary because PIEs with late balance dates will not necessarily have transitioned their investors from 19.5% to the 21% rate (introduced in the 2009 Budget) at 1 October 2010. Without the amendment, those PIEs would not have been able to use the section as it was intended.

Amendments to the existing PIR transitional rule (section HM 60)

The Taxation (Budget Measures) Act included a transitional method for PIEs to apply the 1 October PIR change. This Act makes two remedial amendments to that transitional rule.

- In section HM 60(3), the words "in every period for the income year" are replaced by "in the period". This change clarifies that quarterly PIEs, which calculate and

pay tax each quarter, need to apply an updated notified investor rate only to the current and future quarters. PIEs with yearly calculation periods must apply the rate most recently notified by an investor to every day in the current income year.

- Despite the above rule, for the 2010–11 income year, a PIE with a yearly calculation period only has to apply a tax rate notified on or after 1 October to every day on or after 1 October. For days before 1 October, the PIE has a choice: it can apply the pre-Budget tax rate that corresponds to the newly notified rate, or it can choose not to adjust the investor's tax liability for days prior to 1 October.

The Taxation (Budget Measures) Act also repealed the exemption to the rule in section HM 60(3), described above. This exemption applied if the PIE made voluntary payments of tax to meet an investor's tax liability under section HM 45. The repeal was unintended. This Act reinstates this exemption through new subsection 3B.

Application date

These amendments apply from 1 October 2010.

IMPUTATION ADDITIONAL TAX ON LEAVING AND JOINING WHOLLY-OWNED GROUPS

Sections OB 71–72B of the Income Tax Act 2007

Background

What are colloquially known as the imputation credit shopping rules are being amended to remove their over reach. These rules are designed to prevent one group of companies obtaining imputation credits from another group of companies' tax liabilities. When dealing with prepaid tax (where the associated imputation credits have been distributed to shareholders) even a minor change in shareholding can, in some circumstances, trigger the rules. This is inappropriate.

Key features

The main change is to Section OB 72(5) for a company which was part of a wholly-owned group and joins a new wholly-owned group. In respect of excess entitlements, it now provides that the company is liable for imputation penalty tax if a group of people hold common voting interests in the new group that exceed by 67% or more the common voting interests in the former group that are held by the same people immediately before the company joins the new group. Previously, the imputation penalty tax in this situation was payable where there was any change of ultimate shareholders in a wholly-owned group.

However, where the company joins a new wholly-owned group and the imputation additional tax is not payable in respect of an excess entitlement under section OB 71, the use of income tax refunds due to that company are then restricted by the new section OB 72B. Subsection (5) then restricts the use of the refunds in two ways:

- Imputation credits which:
  - were derived from tax paid by the company or by a company in the same wholly-owned group (and was in that group immediately before joining the new group);
  - are attached to a dividend in relation to a shareholding by the company for a company in the same wholly owned group (and which was in that group immediately before joining the group and had that shareholding at that time).
- To satisfy a tax liability of the company itself or a company (the member) that is in the same wholly-owned group as the company, if the company satisfies the Commissioner that the member was in the former group immediately before the company joined the new group.

As section OB 72 now allows a change in shareholding in a wholly-owned group of up to (but less than) 67%, section OB 72B provides a mechanism for tracking various shareholding changes in a wholly-owned group to determine if and when the 67% trigger occurs. It does this on a cascading basis for subsequent changes of shareholding which need to be calculated for each wholly-owned group which emerges from any change of shareholders.

Section OB 72B imposes an additional imputation tax liability for the restricted refund amount on the same basis that the imputation additional tax is payable for an excess entitlement in section OB 72.

There have been other changes to sections OB 71 and OB 72 which are clarifying the provisions which may have become unclear following the rewrite of the Act. They are not policy changes.

It should be noted that these provisions were introduced prior to a planned review of the policy framework of the imputation credit rules and that review is likely to result in a rewrite of these provisions.

Application dates

The changes to section OB 71 take effect from 1 April 2008 and the changes to sections OB 72 and OB 72B take effect from 1 March 2010.

REMEDIAL MATTERS

AMENDMENTS TO THE GOODS AND SERVICES TAX ACT 1985

Section 20C of the Goods and Services Tax Act 1985

A technical change to the formula in section 20C of the Goods and Services Tax Act 1985 has been made to ensure it produces the correct amount.

Background

In 2005, changes were made to the GST Act which zero-rated certain business-to-business supplies of financial services. The changes allowed suppliers of financial services to deduct input tax when previously such supplies were treated as exempt from GST (input tax deductions were not allowed).

Financial services supplied between financial services providers (such as banks) cannot, however, be zero-rated under the 2005 changes because most recipient financial services providers (the "direct supplier" in section 20C) will not satisfy the specific requirements of the zero-rating rules in sections 11A(1)(q) and (r). Financial services providers are therefore unable to deduct input tax in connection with these transactions because they are still treated as exempt from GST.

The deduction calculated by the formula in section 20C replaces the denied input tax deduction. The formula applies in connection with supplies of financial services between financial services providers. The amount deductible is the product of the formula:

$$a \times \frac{b}{c} \times \frac{d}{e}$$

The formula is based on two fractions which measure the mix of taxable and exempt supplies made by the supplier and the direct supplier in a taxable period. The product of the two fractions is applied to the amount of input tax that cannot be claimed by the supplier for the taxable period.

A problem with the formula was that the denominator in the first fraction (element "c") was the amount of total supplies of financial services made by the supplier. This had the effect of reducing the amount that could otherwise be deducted.

Key features

Section 20C has been amended so that denominator in the first fraction (element "c") is defined as the amount of total exempt supplies made by the supplier.

Application date

The change applies from 1 January 2005, the date that section 20C first had effect.

AMENDMENTS TO THE LIFE INSURANCE TAXATION RULES GRANTING TRANSITIONAL RELIEF

Sections CR 4, DW 4, EY 5, EY 24, EY 25, EY 26, EY 27, EY 30 and YA 1 of the Income Tax Act 2007

A number of changes have been made to the new rules for taxing life insurance business that were enacted as part of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

The changes made by the Taxation (Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010 affect the scope of the grandparenting provisions applicable to life policies, particularly workplace group policies, sold before the start of the new taxation rules. Remedial amendments have also been made to ensure that the new rules achieve their intended policy effect.

Background

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 significantly changed the taxation rules applicable to life insurance business. The new rules are designed to tax the income from term life business so that life insurance companies pay tax on their profits, like any other New Zealand business.

The new rules also contained a comprehensive set of transitional provisions that preserve the previous income treatment of life insurance policies sold before the application date.

In response to submissions received on the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill, the Finance and Expenditure Committee recommended a number of technical amendments to the new rules.

Key features

The main amendments to the new taxation rules for life insurance affect the scope of the transitional rules. Other changes have been made to correct technical problems identified with the new rules. The amendments are consistent with the policy intent of the new taxation rules for life insurance business.

Detailed analysis

Grandparenting of life policies

Section EY 30 provides that policies contracted under the previous rules are grandparented and subject to transitional rules for a specified period. The application of the previous life rules is therefore preserved, for a limited period, for term policies sold before the start of the new taxation rules for life insurance business. Several changes have been made to clarify the scope of the grandparenting rules.

Workplace group policies

A number of technical changes have been made to the definition of "workplace group policy" (section EY 30(15)).

- The definition now includes workplace group policies that are:
  - sponsored by trustees of superannuation schemes;
  - broker-administered pool schemes; or
  - group policies sponsored by industry associations.
- The definition also extends the scope of the life cover provided under a workplace group policy and now includes:
  - business owners or the directors of businesses; and
  - spouses, civil union partners and de facto partners of employees or members covered by the workplace group policy.
- The definition of "workplace group policy", in the context of policies sponsored by an employer, previously required that the policy was "compulsory" for the relevant class of employees. The context and application of the word "compulsory" was unclear. Section EY 30(15) has been changed so that the employer is required to offer the employee the opportunity to join the life insurance policy.
- The requirement about the payment of premiums has also been clarified and allows the life insurer and the employer to reach an agreement about who pays the premium.
- Voluntary top-ups in cover by individuals covered by the workplace group policies are included in with the scope of these changes.

Life policies with a mix of products

New section EY 30(1B) allows elements of a life policy that are capable of being sold separately to be given a different tax treatment if the grandparenting rules provide for a different treatment. For example, a life policy may contain both a level premium policy and a yearly renewable term (YRT) product. New section EY 30(1B) allows the life insurer to treat each life product which can be taken as a separate contract for life insurance, as a "policy" in its own right when calculating transitional relief. Any split or division of a life policy must be transparent to the policyholder, and the supporting policy documentation must clearly show that there is a separate price for each life product that forms part of the life insurance policy.

Previously, the transitional rules treated a life policy as the sum of all its parts. This meant that changes to a life policy that included a YRT product and a level premium product would not qualify for transitional relief if the YRT product ceased to meet the requirements in EY 30(2) or EY 30(5).

Multiple-life policies

Section EY 30(3) has been clarified to allow life insurers to "look though" to the underlying life insured and treat each life accordingly under the grandparenting rules. For example, a group policy that covers a husband and wife can be treated as two contracts for life cover. In the event that an increase in the individual's life cover results in a breach of section EY 30(3)(e), the other lives covered by the policy will remain unaffected unless they too breach section EY 30(3)(e).

Section EY 30(3) applies when the life insurer can look through the life policy to the individual lives covered. The word "can" in the context of section EY 30(3)(b) is directed at whether the life insurer's systems are able look through to the lives insured, taking into account the systems that are employed in the income year in which the transitional relief is claimed.

Life insurance policies

Section EY 30(2) has been redrafted following changes to the treatment of multiple-life policies in section EY 30(3). Changes to section EY 30(3) had the potential to limit transitional relief to multiple life policies if the life insurer's systems could not look through to the individual lives covered. Section EY 30(2) therefore acts a default rule. It is expected to apply to:

- single life policies;
- multiple-life polices (such as husband and wife policies) if the life cover for the individuals is not separately identified; and
- life policies that are not credit card repayment insurance and workplace group policies.

New section EY 30(2)(d) ensures that the redrafted section is limited to lives covered before the start of the new taxation rules for life insurance.

Level-premium policies

Section EY 30(5) has been amended to take into account CPI adjustments that may be made to level-premium

policies if such adjustments are an agreed part of the life policy before the grandparenting start day. These adjustments will not cause level-premium life policies to lose transitional relief under section EY 30.

Life reinsurance of credit card repayment insurance and workplace group policies

Sections EY 30(11) and EY 30(14) have been amended so that transitional relief for life reinsurance of workplace group policies or credit card repayment insurance is based on whether the underlying product is also grandparented.

Increases in life cover during an income year

At the insurer's election, new section EY 30(5B) allows transitional relief for a life policy up to the date that it breaches the grandparenting rules. The deduction calculated under section EY 30(7) can now include part-year amounts – section EY 5(6).

For example, a life insurer compares the level of cover at the beginning of year 2 with the cover at the beginning of year 1. If the level of cover breaches the tolerances in the grandparenting rules, transitional relief will ordinarily end at the beginning of year 1 (section EY 30(10) – meaning of "Cover review period"), unless the life insurer is able to identify the point in time when the breach occurred during year 1.

Consequential changes have been made to sections EY 30(2)(c), EY 30(3)(e), EY 30(7) and EY 30(8) to allow for the transitional relief part-year calculation.

No restoration for life policies that lose grandparenting status

New section EY 30(5C) ensures that life policies that no longer qualify under the grandparenting rules are not restored in the next or subsequent cover review period(s).

Other matters

In addition to the changes to the grandparenting rules, the following sections have been amended to clarify their application.

- The application of sections CR 4 and DW 4 (outstanding claims reserve for general insurance contract) to life insurers has been clarified by inserting references to the definition of "premium" and "pay" in section YA 1. The term "general insurance contract" has also been removed and means that the treatment of insurance contracts set out in International Financial Reporting Standard 4 does not apply to general insurance contracts sold by life insurers. Instead, the reserving rules in section EY 24 apply.
- In section EY 5(4) the transfer of life reinsurance connected with the sale of life business is clarified.
- The provisions relating to the outstanding claims reserve (section EY 24(2)(a)(ii)), the premium smoothing reserve (section EY 25(2)(a)(ii)), the unearned premium reserve (section EY 26(2)(a)(ii)) and the capital guarantee reserve (section EY 27(2)(a)(ii)) have been amended to clarify how the opening balances for these reserves should be calculated for the first year in which the new rules apply.
- The definition of "savings product policy" in section YA 1 excludes situations when all or a portion of a premium connected with life risk is refunded to the policyholder. This should ensure that the return of such amounts does not result in the policy being treated as a "savings product policy".
- A grammatical error in section EY 30(4) has been corrected.

Application date

The changes apply from 1 July 2010. Life insurers have the option to apply the rules from the beginning of their income year, if that year includes 1 July 2010.

PORTFOLIO CLASS LAND LOSS

Sections HL 32 and HM 65 of the Income Tax Act 2007; section HL 30 of the Income Tax Act 2004

Amendments have been made to clarify that land-owning portfolio investment entities (PIEs) that invest offshore can allocate tax losses that arise from foreign exchange contracts to their investors.

Background

Generally, at the end of the year, a PIE receives a cash rebate from Inland Revenue for any tax losses it has made. The PIE then allocates this loss to its investors. An exception to this is that PIEs that invest predominantly in land or land-owning companies ("land PIEs") cannot receive a cash rebate for their tax losses at the end of the year. This is to prevent excessive tax losses arising from heavily geared land investments.

Previously, a problem existed for land PIEs with portfolio investments in foreign land-owning companies. As these investments are often denominated in foreign currency, the PIEs typically enter into foreign exchange hedging contracts to remove or reduce the currency risk associated with the investment. The hedging contracts result in a loss if the foreign currency in which the investment is held appreciates against the New Zealand dollar. Under the previous rules, the PIE was required to carry forward the losses that arose as a result of the hedging contract rather than allocate them to its investors.

Key features

An amendment has been made to the definition of "portfolio class land loss". This was done to clarify that PIEs that own land offshore can allocate tax losses arising from foreign exchange contracts to their investors.

Detailed analysis

PIEs that have investments in foreign land-owning companies typically remove or reduce the currency risk associated with the investment by entering into foreign exchange hedging contracts. These contracts fall within the definition of a financial arrangement, and associated gains and losses are taxable or deductible.

As a result, in years where the foreign currency in which the investment is held appreciates against the New Zealand dollar, the foreign exchange financial arrangement will produce a tax-deductible loss. The land PIE's investment in the foreign land-owning company is generally subject to fair dividend rate (FDR) taxation at 5% and, therefore, always generates income for tax purposes. As the land investment itself cannot generate a tax loss, this was not the type of investment intended to be subject to the land loss rules when they were designed.

In certain years the FDR income generated will not be sufficient to offset the foreign exchange loss and an overall tax loss can arise. Amendments to sections HL 32 and HM 65 of the Income Tax Act 2007, and to section HL 30 of the Income Tax Act 2004 change the definition of "portfolio land class loss" to clarify that the land PIE is not required to carry such losses forward but can instead allocate tax losses that arise from foreign exchange contracts to its investors. This is consistent with the policy intent of the PIE rules when they were enacted.

Application dates

The amendments to section HL 32 of the Income Tax Act 2007 and section HL 30 of the Income Tax Act 2004 will apply from 1 October 2007, the date the PIE rules were introduced.

The amendment to section HM 65 of the Income Tax Act 2007 will apply from 1 April 2010, the date the rewritten PIE rules apply from.

NEW ZEALAND SCREEN PRODUCTION INCENTIVE

Sections DS 2, EJ 4, EJ 5, EJ 7, EJ 8 and YA 1 of the Income Tax Act 2007 and section 3 of the Tax Administration Act

Amendments have been made to the Income Tax Act 2007 to provide that the tax treatment of expenditure on a film does not depend on whether the film receives a New Zealand screen production incentive. The amendments also provide that special tax treatment of expenditure on films that receive a large budget screen production grant is also expressly applied to expenditure on films that receive a post-production digital and visual effects grant.

Background

The Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009 amended the Income Tax Act 2007 to give expenditure on films receiving a New Zealand screen production incentive the same treatment as expenditure on films receiving a large budget screen production grant. These amendments reverse that decision.

Key features

Amendments have been made to the Income Tax Act 2007 to provide that the tax treatment of expenditure on a film does not depend on whether the film receives a New Zealand screen production incentive.

The special treatment under the Act of expenditure on films that receive a large budget screen production grant has been also expressly applied to expenditure on films that receive a post-production digital and visual effects grant. This amendment confirmed the current treatment of such expenditure.

The amendments to the Income Tax Act 2007 included the removal of the definition of "government screen production payment" and the insertion of a definition of "large budget film grant", which means a large budget screen production grant or a post-production digital and visual effects grant.

A definition of "government screen production payment" has been inserted in the Tax Administration Act 1994 for the purposes of provisions relating to the transfer of information on films receiving a New Zealand screen production incentive, a large budget screen production grant, or a post-production digital and visual effects grant.

Application date

The amendments apply from 1 January 2010, the date the previous, now reversed, amendments, applied from.

TAX TREATMENT OF PAYMENTS TO PUBLIC OFFICE HOLDERS

Schedule 4, part B of the Income Tax Act 2007

The Income Tax Act 2007 has been amended to clarify the tax treatment of payments made to certain public office holders.

Background

Schedular payments are generally certain payments made when the relationship between the parties is not strictly one of employer and employee. Schedular payments made to non-employees are subject to withholding tax. They are treated as PAYE income payments for the purposes of the PAYE rules.

Payments made to certain public office holders were subject to withholding tax as they were covered under the definition of "honoraria" in the Income Tax (Withholding Payments) Regulations 1979. However, after the rewrite of the Income Tax Act, it became unclear how payments made to certain public office holders should be taxed. Schedule 4 of the Income Tax Act 2007 that set out the rates of tax to be withheld from schedular payments did not explicitly include payments made to certain public office holders. As a result, there was no explicit authority for the payers of fees to public office holders to withhold tax from those payments.

Key features

Schedule 4, part B of the Income Tax Act 2007 has been amended to clarify that payers must withhold tax from payments made to certain public office holders.

Schedular payments are subject to a tax rate of 33% for each dollar of payments made for work or services performed by:

- a local government elected representative;
- an official of a community organisation, society, or club;
- a chair or member of a committee, board or council; or
- an official, chair, or member of a body or organisation similar to the ones described above.

The term "honorarium" defined in section CW 62B has been amended so that it applies for the purposes of that section only.

Application date

The amendment applies for payments made in the 2008–09 and later income years other than a payment:

- for work or services performed before 7 September 2010; and
- from which the payer is not obliged to withhold an amount of tax, ignoring this amendment.

IFRS FURTHER REMEDIAL: ANTI-ARBITRAGE RULES FOR CERTAIN METHODS

Sections EW 15E–15F of the Income Tax Act 2007; sections EW 15D and EW 15E of the Income Tax Act 2004

The Act makes a remedial amendment to the anti-arbitrage rules for IFRS taxpayers. Each of the above sections has had a new sub-paragraph added to them to ensure they fully implement the original policy for use of the relevant methods.

Key features

The amendments ensure that the relevant methods can be used for financial arrangements which are treated under IFRS as hedges of non-financial arrangements. The sections now reflect that the anti-arbitrage rules apply to financial arrangements which are in an IFRS-designated hedging situation.

A further amendment is proposed to the anti-arbitrage rules in legislation to be introduced in late 2010. The anti-arbitrage rules are intended to prevent income and expenditure from being deferred or advanced on two financial arrangements which are in an IFRS-designated hedging relationship. However, in amending the rules in 2009 the ability to use the fair value method for financial arrangements that are used to hedge other financial arrangements (being agreements for the sale and purchase of property in foreign currency subject to a determination method – G9) was inadvertently denied. Inland Revenue proposes to correct this error, allowing the fair value method to be used in such circumstances. This amendment will be on very specific terms and it will not be intended to otherwise alter the application of the anti-arbitrage rules or the taxation of the agreements for sale and purchase of property in foreign currency under determination G9.

Application date

The amendments apply from the date of the original legislation, being 1 April 2007 for the Income Tax Act 2004 and 1 April 2008 for the Income Tax Act 2008.

FINANCIAL ARRANGEMENTS SUBJECT TO DETERMINATIONS G22 AND G22A

Sections EZ 52C and EZ 52D of the Income Tax Act 2007

On 26 September 2006 Determination G22 was replaced with Determination G22A. The stated purpose of the replacement was to deny artificial deductions on certain optional convertible notes (OCNs) that were being claimed by New Zealand subsidiaries of overseas companies. Many of these arrangements are currently the subject of litigation between Inland Revenue and the taxpayers concerned.

At that stage the tax Act in force was the Income Tax Act 2004. That Act and its replacement, the Income Tax Act 2007, provide that when a determination is "cancelled" it remains in force for another four years for arrangements (the grandparented OCNs) that were in place when it was cancelled.

Key features

Under black letter law, tax deductions are available in respect of the grandparented OCNs until G22A becomes effective in respect of the grandparented OCNs.

Specifically, for the grandparented OCNs there is a need to ensure that:

- the change of spreading method adjustment that would have effect when the G22 expires for the grandparented OCNs in September 2010 does not claw back any deductions taken under G22 that are eventually allowed; and
- when the base price adjustment (BPA) is eventually calculated on the grandparented OCNs, it does not claw back any deductions taken under G22 that are eventually allowed.

Sections EZ 52C and EZ 52D have been inserted into the Income Tax Act 2007 to achieve these objectives. Inland Revenue consulted extensively with interested parties and their advisors on the provisions necessary to amend the legislation.

Detailed analysis

Changing from G22 to G22A

Section EZ 52C provides that when a taxpayer has been using G22 for a financial arrangement and is changing to G22A for that arrangement, a change of spreading method adjustment under sections EW 26 and EW 27 is not performed. Instead the taxpayer will apply the spreading method that has been followed in previous years under G22 for the portion of the income year up to the date of change in that income year. For the remainder of that income year and the following income years it will apply a spreading method under G22A to the financial arrangement. For the grandparented OCNs that means there will be no tax deductions for the remainder of the income year in which the change is made from G22 to G22A and for all subsequent income years.

BPA where both G22 and G22A have applied

As stated above, the BPA performed at maturity of a grandparented OCN to which both G22 and G22A have applied should not claw back any deductions taken under G22 that are eventually allowed. This has been achieved by making an adjustment to the consideration to be used in the BPA calculation for OCNs to which both G22 and G22A have applied.

The consideration for a financial arrangement in these situations has been amended by section EZ 52D for both the issuer and the holder in terms of G22 and G22A. The consideration in both cases is amended by an amount calculated as follows.

> "X – Z"
>
> **where "X":** is an amount equal to the item s in Determination G22, clause 6(1), if that item were calculated in accordance with that determination at the time immediately before the change of spreading method described in section EZ 52C(2).
>
> Item s in clause 6(1) of G22 is the present value of the cash flows in respect of the OCN and the person. In G22 item s is used as part of the calculation of the core acquisition price of a convertible note attributable to the option to buy or sell shares (which is an excepted financial arrangement).
>
> Therefore the amount for X in Section EZ 52D is the present value of the cash flows in respect of the OCN and the person calculated up to and including the day before the taxpayer starts using G22A. It is effectively what item s would be if the OCN were to start at that moment and consisted of only the cash flows which were to occur from that moment into the future. In respect of grandparented OCNs that moment is effectively midnight of the day being 25 September 2010, as G22A applies from 26 September 2010; and
>
> **where "Z":** is an amount equal to the item s in Determination G22, clause 6(1), if that item were calculated in accordance with that determination at the time when the determination first applied. So Z is therefore the original amount of s (being the present value of the debt component of the OCN on its date of issue) when the taxpayer started applying G22 to the financial arrangement.

When calculating the BPA for a grandparented OCN, the amount of X – Z is added to all consideration paid/payable by the issuer and added to all consideration paid/payable to the holder. This will mean that the resulting BPA will not reverse deductions taken by the issuer under G22 that are eventually allowable. It will also mean that revenue returned by the holder is not reversed.

Example

For a grandparented OCN with a term of 10 years and a face value (FV) of $1 million, under G22 the warrant (equity) component of the OCN is determined to equal $491,650.71 in accordance with the formula "y – s" in clause 6(1) of G22.

y = $1,000,000 being the total consideration paid for the OCN

s = the present value (PV) of the bond component
= $508,349.29 and is deemed to be a zero coupon bond discounted at the "specified rate" of 7%

y – s = 1,000,000 – 508,349.29 = 491,650.71

The table below sets out the accrual expenditure and tax book values for the OCN.

FV		**1,000,000**		
Term		10 years		
Specified rate		7.00%		
PV		**508,349.29**		
	# of days	**Starting tax book balance**	**Accrual expenditure**	**Ending tax book value**
1/04/2004		508,349.29	35,584.45	543,933.74
1/04/2005	365	543,933.74	38,075.36	582,009.10
1/04/2006	365	582,009.10	40,740.64	622,749.74
1/04/2007	365	622,749.74	43,592.48	666,342.22
1/04/2008	366	666,342.22	46,643.96	712,986.18
1/04/2009	365	712,986.18	49,909.03	762,895.21
1/04/2010	365	762,895.21	25,591.74	**788,486.95**
25/09/2010	178	788,486.95	27,810.92	816,297.88
1/04/2011	187	816,297.88	57,140.85	873,438.73
1/04/2012	366	873,438.73	61,140.71	934,579.44
1/04/2013	365	934,579.44	65,420.56	1,000,000.00
1/04/2014	365	1,000,000.00		
Total deemed/implied interest			491,650.71	
Accrual expenditure up to 25 Sep 2010			280,137.66	

The deemed equity component of $491,650.71 is deducted from the total consideration paid for the OCN of $1 million, which leaves the amount attributable to the financial arrangement of $508,349.29 (1,000,000 – 491,650.71 = 508,349.29).

Over the term of the arrangement the debt component of $508,349.29 tends towards its FV of $1,000,000 at maturity. The difference ($491,650.71) is deemed to be interest and is accrual expenditure calculated on a yield-to-maturity (YTM) basis for each year over the 10-year term of the arrangement.

For G22 deductions which are eventually allowable, the total accrual expenditure that should be allowed according to the example is $280,137.66. This is highlighted on the table above and is the amount, under a YTM calculation process, that would be allowed up to 25 September 2010.

The application of G22A works to disallow any deemed accrual expenditure from 26 September 2010, if the parties to a grandparented OCN are members of the same wholly owned group of companies and the conditions described in clause 4(3) of G22A are applicable.

However, without these amendments and given the definitions and methodology contained in G22A, when a BPA is calculated, the result would otherwise be accrual income to the issuer of $280,137.66.

The reason is that the consideration attributable to the bond component of the OCN would otherwise be $1,000,000, in combination with the accrual expenditure deduction in earlier income years of $280,137.66. This can be demonstrated as follows:

BPA = consideration – income + expenditure + amount remitted

BPA = (+1,000,000 – 1,000,000) – 0 + 254,545.92 + 0
= 254,545.92

The remedial changes in Section EZ 52D provide for a "consideration adjustment" defined as:

"X – Z"

where "X" is the PV of the debt component of the OCN as at 26 September 2010 (up to and including 25 September 2010). From the table above, this amount is shown in red, as $788,486.95.

where "Z" is what "S" would have been under G22—in other words, the PV of the debt component of the OCN when it was issued at the start. In the example the PV of the bond on the issue date is $508,349.29.

So when the BPA is recast, the following outcome is achieved:

BPA = (+508,349.29 – 788,486.95) – 0 + 280,137.66 + 0
= 0

The result of the proposed changes is that the BPA will not claw back the $280,137.66 of accrual expenditure claimed up to and including 25 September 2010.

NEW LEGISLATION

Note also that the G22 deduction eventually allowed for the part year when the change of method from G22 to G22A occurs (assuming a 31 March tax balance date) will be the $25,591.74 amount in the table above, which results from the application of section EZ 52C explained above.

Sections EZ 52C and EZ 52D apply so that a litigant and the Commissioner may not use the application of sections EZ 52C and EZ 52D on or after 26 September 2010 for their positions in respect of Determination G22.

Application date

The commencement date for these amendments was 26 September 2010.

FINANCIAL INSTITUTION SPECIAL PURPOSE VEHICLES

Sections HR 9–HR 10 and Section YA 1 of the Income Tax Act 2007

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 inserted sections HR 9 and HR 10 into the Income Tax Act 2007 to deal with the tax treatment of registered banks' residential mortgage backed securities (RMBS) special purpose vehicles (SPVs) (see *Tax Information Bulletin* Vol. 21, No. 8, October/November 2009, pages 131–132). Those rules removed the tax impediments to banks using the Reserve Bank's (RBNZ) RMBS liquidity facility.

Key features

In March 2010 the RBNZ introduced a new bank liquidity policy, which includes measures to require banks and certain finance companies (lenders) to lengthen the term of their funding to better match their lending terms. One of the strategies proposed by lenders to achieve this, at the lowest cost, is by issuing debt which is guaranteed by bankruptcy remote SPVs. They are commonly called covered bond programmes (CBPs). The structure of the establishment of the CBP-SPVs by the lenders is economically very similar to the RMBS-SPVs.

Establishing and operating the SPVs would have caused unwarranted tax volatility for the lenders and the government, and the major purpose of these amendments is to remove this volatility. Lenders have to set up the CBP-SPVs (typically companies or trusts), which they control but do not own. The lender then transfers parcels of financial assets to this vehicle. When fixed rate financial assets are transferred to the SPVs there would have been either a tax gain or loss on transfer (which could be substantial) without these amendments.

To provide the same tax outcome for the establishment and operation of CBP-SPVs as that achieved last year for the RMBS, the 2009 legislation for RMBS has been modified and extended to include CBP-SPVs. This has been achieved by making the provisions as generic as possible to include both these situations. The following specific amendments have been made.

Detailed analysis

Section HR 9

All references in the headings and section to "RMBS" and "RMBS special purpose vehicle" have been replaced with "financial institution" and "financial institution special purpose vehicle" respectively. This is to recognise that the provisions are now applied generically to a "financial institution" and a "financial institution special purpose vehicle" (FI-SPV) as defined in Section YA1 and that they apply to both RMBS and CBP-SPVs. The new definitions have been inserted into section YA1 and the definition of "RMBS special purpose vehicle" has been repealed. The application of the operative provisions of section HR 9 has not changed from that outlined in *Tax Information Bulletin* Vol. 21, No. 8, October/November 2009, page 131, as follows.

Once the existence of an FI-SPV has been established as set out above, the following tax consequences apply:

- The financial institution is treated as carrying on the activities that the FI-SPV carries on, and having a status, intention and purpose of the FI-SPV, and the FI-SPV is treated as not carrying those activities, and not having that status, intention and purpose.
- The financial institution is treated as holding all property that the FI-SPV holds, and the FI-SPV is treated as not holding it.
- The financial institution is treated as being party to any arrangement which the FI-SPV is party to, and the FI-SPV is treated as not being party to that arrangement.
- The financial institution is treated as doing a thing and being entitled to a thing that the FI-SPV does or is entitled to do, and the FI-SPV is treated as not doing that thing or being entitled to that thing.

The tax effect of these provisions is that the financial institution is treated as doing everything that the FI-SPV does while it remains a qualifying FI-SPV, and the FI-SPV is treated as not doing those things while it is a qualifying FI-SPV.

Practically, this will mean that transactions between the financial institution and the FI-SPV will have no tax consequences for either party while the FI-SPV remains a qualifying FI-SPV.

Also, all transactions with third parties by the financial institution and the FI-SPV will be included in the financial institution's tax return while the FI-SPV remains a qualifying FI-SPV.

It also means the FI-SPV will not be required to obtain an IRD number or file income tax and GST returns while it continues to qualify.

Section HR 9B

New section HR 9B has been inserted into the Act to clarify what property of the financial institution can be attached, charged, disposed of or otherwise used ("attach/ed") in the payment of its tax debt while the FI-SPV continues to qualify as an FI-SPV. Subsection (a) applies to the tax debt of the financial institution which is not for income tax or provisional tax, and would have been the FI-SPV's tax debt if HR 9 did not apply to treat the financial institution as doing everything that the FI-SPV does while it remains a qualifying FI-SPV.

As well, the property to be attached must have been able to be attached in the absence of section HR 9 ie if the FI-SPV was a separate entity.

For example, if the FI-SPV had failed to deduct and pay an amount of NRWT from interest it had paid and that amount remained due to Inland Revenue, the FI-SPV's property could be attached by Inland Revenue at any time while it is a qualifying FI-SPV to recover that debt.

Subsection (b) preserves Inland Revenue's ability to attach the property of the FI-SPV while it is a qualifying SPV for tax debts of the financial institution if Inland Revenue would have otherwise under law been able to attach the property of the FI-SPV as a completely separate entity from the financial institution (if HR 9 did not exist). In some rare instances Inland Revenue has the ability to attach the property of taxpayers for the tax debts of other taxpayers, and the policy is that those rights are maintained here as if the financial institution and the FI-SPV were separate taxpayers. An example of this situation in a general context is if taxpayer A owes Inland Revenue a tax debt and Inland Revenue is aware that taxpayer B owes taxpayer A some money. Inland Revenue has the ability to direct taxpayer B to pay Inland Revenue the money it owes taxpayer A in payment of taxpayer A's tax debt. If taxpayer B refuses to pay the money to Inland Revenue, Inland Revenue can then attach property of taxpayer B to recover the money owed to taxpayer A (and Inland Revenue). This provision applies here as if the financial institution and the FI-SPV are always separate persons.

Section HR 10

All references in the heading and the section to "RMBS" and "registered bank" have been replaced with "financial institution". These changes reflect that the deleted words were relevant when the legislation applied to RMBS-SPVs only and the new words are relevant to it applying to RMBS and CBP-SPVs.

Subsection (4) has been replaced to reflect that the relevant SPV being unwound is either a RMBS-SPV or a CBP-SPV. The latter would involve the cancellation on unwind of guarantees it had issued.

Section YA 1

The definition of "RMBS special purpose vehicle" has been repealed effective from the date of Royal assent (7 September 2010). A new definition of "financial institution special purpose vehicle (FI-SPV)" has been inserted, also effective 7 September 2010. An FI-SPV is defined as a company or a trust that:

(a) Derives no exempt income; and

This criterion is the same as that which applied to a RMBS SPV.

(b) Has all of its financial arrangements that are its assets treated as a financial institution's financial arrangements for financial reporting purposes, but ignoring any current account balance that is incidental to the company's or trustees sole purpose described in paragraph (e); and

This criterion has been changed from that which applied for RMBS-SPVs in two respects. The first is that the FI-SPV's financial arrangements assets are treated as the financial institution's assets for financial reporting purposes. The RMBS-SPV definition referred only to interests in New Zealand – originated residential mortgages, or loans secured by those mortgages. The new definition caters for FI-SPVs, which may be able to hold a wider range of financial arrangements as assets. Secondly, it excludes an asset which is a current account balance (say held with a bank) that is incidental to the company's or trustee's sole purpose described in paragraph (e) and may not be included in the financial institution's financial reporting.

Inland Revenue considers that this provision would cover an asset of an FI-SPV which was (say) the fair value of a swap with the financial institution as the counterparty and which the financial institution would, on a stand-alone basis excluding the FI-SPV, include as a liability in its financial reporting. Including the FI-SPV's assets in the financial institution's financial reporting will mean that the swap asset of the FI-SPV is netted out with the financial institution's swap liability for a net amount of nil to be reported by the financial institution. This would satisfy the terms of this criterion for that swap asset.

(c) Receives only funds that are—

 (i) in respect of financial arrangements described in paragraph (b);

 (ii) incidental to the company's or trustees' sole purpose described in paragraph (e); and

The intent of this criterion remains unchanged from that which applied to RMBS-SPVs which referred to funds provided to the RMBS-SPV related to the residential mortgage backed securities it has issued or to financial arrangements incidental to its operations. In both cases the provisions are directed at limiting the funding that the SPVs obtain to that for obtaining the financial arrangements assets it holds which are referred to in paragraph (b) or amounts incidental to its sole purpose, such as an overdraft for working capital purposes. It is expected that the latter amounts will be very minor in terms of the FI-SPV's balance sheet and be for very short periods, that is, not used as core funding of the FI-SPVs.

(d) Either—

 (i) operates to guarantee liabilities of the financial institution or of a company, incorporated in and resident in New Zealand, that is a member of a wholly-owned group of companies which includes the financial institution; or

 (ii) operates in respect of the company's or trustees' issue of residential mortgage backed securities; and

This criterion has changed in two significant respects from that which applied under the RMBS-SPV definition. The first is that it caters for the CBP-SPVs operations, being to guarantee the liabilities of a New Zealand resident wholly owned group company. Secondly, it includes the operations of an FI-SPV which issues residential mortgage backed securities and therefore carries on and broadens what the previous definition of a RMBS-SPV allowed for. An FI-SPV which operates to issue residential mortgage backed securities now can issue those securities to any person and those securities can be on-sold by the financial institution to any person. The definition of RMBS-SPV effectively restricted the holding of the securities issued by an RMBS-SPV to either the financial institution; the Reserve Bank; or certain persons the Reserve Bank transferred them to after it had accepted them into its domestic liquidity operations.

(e) Has interests in financial arrangements only for the sole purpose of carrying out the company's or trustees' operations described in paragraph (d)(i) or (ii); and

This provision is new compared to the definition of RMBS-SPV. Its purpose is to limit for tax purposes what qualifying FI-SPVs are permitted to do. It was included in the legislation after consultation with interested taxpayers and given the facilitative nature of the government's policy position on the undesirable tax outcomes which would otherwise apply.

(f) Has financial statements that are prepared using IFRSs and are audited.

This is a new provision and was included after consultation with interested taxpayers.

Application date

The changes apply from 1 June 2010.

REMEDIAL AMENDMENTS TO PORTFOLIO INVESTMENT ENTITY TAX RATES

Schedule 6, table 1 of the Income Tax Act 2007

Table 1 of schedule 6 of the Income Tax Act 2007 sets out the tax rates for investors in portfolio investment entities.

Amendments have been made to ensure that the prescribed investor rates (PIRs) and income thresholds for New Zealand resident natural person investors are accurate.

Additionally, row 2 has been amended to clarify that the 30% PIR applies to all non-resident investors, whether or not they have provided a notification.

Application date

The changes apply from 1 April 2010.

RESIDENT WITHHOLDING TAX RATE REMEDIALS

Schedule 1, part D, tables 2 and 3 of the Income Tax Act 2007, section 25A of the Tax Administration Act 1994

Resident withholding tax (RWT) rates on interest income were aligned with the current company and individual income tax rates on 1 April 2010. Minor remedial amendments have been made in order to clarify the changes. (Note that the Budget 2010 legislation reduced RWT rates, as a consequence of changes to personal tax rates. These new rates will apply from 1 October.)

A minor amendment has also been made to section 25A of the Tax Administration Act 1994.

Key features

Minor amendments to RWT rates

- ***Schedule 1, part D, tables 2 and 3*** – Amendments have been made to clarify the transition to the new 38% RWT

rate for individuals and companies which elected the 39% rate before 1 April 2010.

- ***Schedule 1, part D, clause 4*** – A change has been made to ensure that trustees which are portfolio investment entities are able to use the company RWT rates set out in table 3 of schedule 1, part D.

Inland Revenue's ability to instruct interest payers to change RWT rates

Section 25A was introduced into the Tax Administration Act 1994 last year. It allows Inland Revenue to identify individuals who are on an RWT rate that is inconsistent with their marginal tax rate and instruct interest payers to shift those individuals to the appropriate rate.

An amendment has been made to ensure that the section applies when any individual has had tax withheld by their interest payer at an inappropriate rate (whether elected or not), instead of only where an individual has elected an inappropriate RWT rate.

Application date

The changes apply from 1 April 2010.

REMEDIAL AMENDMENTS TO THE PIE RULES

Sections HL 4, HL 9(2), HM 25(3)(b), HM 52, HM 60(4), HM 69(5), LS 2(2), LS 2(3), YA 1 and Schedule 29 of the Income Tax Act 2007; sections 31(2B)(a), 36C and 40(2)(a) of the Tax Administration Act 1994

A number of remedial amendments have been made to the tax rules for portfolio investment entities (PIEs). These amendments ensure that the rules achieve their intended policy effect.

Key features

Use of formation losses

The Act amends section HM 69(5) to ensure that, after the three-year spread required by HM 69(2), any residual formation loss is available for use by the relevant PIE investor class. Specifically, the rule has been amended to provide that any residual amount of tax loss is allocated to the PIE's next attribution period and can be used in its calculation of taxable income for the investor class under HM 35(5).

Other technical amendments

A number of amendments have been made to correct minor drafting and cross-referencing errors. These include:

- In Schedule 29 of the Income Tax Act 2007, the reference to "a community trust" is moved from Part B to Part A. This updated schedule now reflects the treatment of community trusts under the pre-rewrite rules, subpart HL.
- Section HM 25(3)(b) is amended so that a PIE (or investor class) does not lose PIE status if, within three months of the end of a quarter in which it has breached the PIE rules, the PIE announces that it will be wound up within 12 months.
- Section HM 60(4) is amended to remove the reference to CX 56B. If an investor has notified an incorrect rate to a PIE, the income attributed to them by that PIE will be treated as taxable under CX 56. It is therefore unnecessary to also treat distributions or dividends paid by that PIE as taxable income.

Application date(s)

There are various application dates for these remedial changes to the PIE rules.

REMEDIAL AMENDMENT TO THE QUALIFYING COMPANY RULES

Section YA 1 of the Income Tax Act 2007

Background

A qualifying company is required to earn no more than $10,000 in foreign non-dividend income. If this amount is exceeded, the company is unable to be a qualifying company.

This test was affected by the repeal of the grey-list tax rules and the introduction of the fair dividend rate (FDR) rules. Income derived under the FDR rules is not treated as dividends, and therefore contributed to the $10,000 limit for qualifying companies.

Key features

The Act amends the definition of non-dividend income in section YA 1 so that it does not include foreign investment fund income calculated under the FDR method. As such, income derived under the FDR rules no longer counts towards the limit on foreign non-dividend income for qualifying companies.

Application date

The amendment applies from 1 April 2008.

USE-OF-MONEY INTEREST ON KIWISAVER REFUNDS

Section 86(1) of the KiwiSaver Act 2006

Inland Revenue pays use-of-money interest (UOMI) on money refunded to KiwiSaver members—for example, a member's personal contributions if they subsequently opt out. UOMI paid by Inland Revenue on KiwiSaver contributions is exempt income for tax purposes. The interest is calculated net of tax. The net-of-tax calculation is based on the lowest tax rate for individuals.

Section 86(1) has been amended, consequential to the 1 October 2010 personal tax rate changes, to ensure that the UOMI rate continues to be calculated and paid at 12.5% until 30 September 2010, and then 10.5% from 1 October 2010.

Application date

The amendment applies for 2010–11 and future tax years.

UNCLASSIFIED FRINGE BENEFITS

Section CX 16(4) of the Income Tax Act 2004 and section CX 17(4) of the Income Tax Act 2007

Sections CX 17(4) of the Income Tax Act 2007 and CX 16(4) of the Income Tax Act 2004 have been amended retrospectively, with an appropriate savings provision, to prevent a company from electing to treat any benefit provided to a shareholder-employee as a dividend.

Background

The Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 amended section CX 16(4), by replacing the punctuation between paragraphs (a) and (b) in section CX 16(4) of the 2004 Act. This punctuation change resulted in a change in outcome of the rule that was inconsistent with the policy intention of the rule.

Section CX 16(4)(a) and (b) permit a company to elect to treat an "unclassified benefit" provided to a shareholder-employee as a dividend instead of being a fringe benefit). This election was not intended to be available to other types of fringe benefit that were specifically listed (such as, for example, a motor vehicle).

However, as previously drafted, both sections permitted a company to elect that any benefit provided to a shareholder-employee be treated as a dividend. Both sections have been amended to ensure that the election can only be made in relation to an "unclassified benefit".

Application date

The amendments apply from the beginning of the 2005–06 income year (both the 2004 and 2007 Acts have been amended). A savings provision for both sections CX 17(4) (of the 2007 Act) and CX 16(4) (of the 2004 Act) applies to protect taxpayers who may be adversely affected by the retrospective amendment.

REWRITE AMENDMENTS

The amending Act includes a number of remedial changes to the Income Tax Act 2007, at the recommendation of the Rewrite Advisory Panel. The Panel sets out submissions relating to these changes on its website (**www.rewriteadvisory.govt.nz**). It also lists its conclusions and recommendations for each submission.

Application dates

Unless otherwise stated, the following amendments apply from the beginning of the 2008–09 income year.

Mutual associations and the mutuality principle

Sections CB 33 of the Income Tax Act 2007 Act has been amended retrospectively to ensure it overrides the common law principle of mutuality in the same manner as its corresponding provision in the Income Tax Act 2004 (section HF 1(1)).

Section DV 19 of the 2007 Act has been amended retrospectively to ensure that an association may deduct an association rebate paid to members to the same extent as was allowed under the corresponding provision in the 2004 Act (section HF 1(2)).

Section CB 33 of the 2007 Act contained an unintended change in that it did not override the principle of mutuality in the same manner as its corresponding provision in the 2004 Act (section HF 1(1)).

The principle of mutuality arises under common law. The Courts consider that a person cannot derive taxable income from mutual transactions, as a mutual transaction is of a similar nature to trading with oneself. Section CB 33 has been amended to ensure that it overrides the common law principle of mutuality for any amount derived that would otherwise be income under the Act.

A "mutual association" is allowed a deduction, under section DV 19 of the 2007 Act, for a distribution to its members of net taxable profits (termed "an association rebate"). Section DV 19 of the 2007 Act contains an unintended change in outcome that results in a smaller deduction than was allowed under its corresponding provision in the 2004 Act (section HF 1(2)).

Section DV 19 has been amended to restore the effect of section HF 1(2) of the 2004 Act. The amendment ensures that the amount of the deduction for the association rebate is no greater than the part of the association's net income that arises from certain types of transactions made between the association and its members.

Accumulated tax depreciation and mothballed assets

Sections EE 60(3B) of the Income Tax Act 2007 and EE 51(3B) of the Income Tax Act 2004 have been amended to ensure that if a depreciable asset has been withdrawn from use in a business (for example, mothballed), for the purpose of determining the amount "total deduction" in calculating an asset's "adjusted tax value", the accumulated depreciation of that asset remains the same while the asset remains withdrawn from the business.

The Rewrite Advisory Panel agreed with a submission that section EE 51(3)(b) of the 2004 Act contained an unintended legislative change, and that this unintended change had been re-enacted in section 60(3)(b) of the 2007 Act. The unintended change was that in calculating the "adjusted tax value" for a "mothballed asset", the amount of accumulated depreciation continues to be calculated for each period, despite no deduction being allowed for the depreciation loss calculated.

The insertion of a new subsection (3B) in each of sections EE 60 and EE 51 ensures that during the period a depreciable asset is permanently withdrawn from use in a business, accumulated depreciation is stopped at the time of that withdrawal from business use. An example when the rule is intended to apply is if a taxpayer "mothballs" an asset, such as plant or equipment, which has become obsolete and replaced.

Application dates

The amendments apply from the beginning of the 2005–06 income year (both the 2004 and 2007 Acts being amended to give effect to this application).

Meaning of "controlled foreign company"

The amendment restores the meaning of "controlled foreign company", as given by section CG 4(2)(b) of the 1994 Act. The amendment has been made to section EX 1(1)(b) in both the 2004 and 2007 Acts.

The Rewrite Advisory Panel agreed with a submission that section EX 1(1)(b) of the 2004 and 2007 Acts did not correctly reflect the outcome given in section CG 4(2)(b) of the 1994 Act.

Under section CG 4(2)(b) of the 1994 Act, a foreign company was not a controlled foreign company if a non-resident shareholder's control interests were:

- at least equal to or greater than 40 percent; and
- there was no single New Zealand-resident shareholder having control interests greater than the control interests of the non-resident.

The provision is retrospective and has the effect of validating the actions of taxpayers who have continued to:

- disclose their interests in a foreign company as an interest in a controlled foreign company; and
- return their attributed CFC income from controlled foreign companies.

A savings provision applies to taxpayers who have taken tax positions in relation to whether the person has an interest in a controlled foreign company:

- in a return of income filed before the last date of the period to which the savings provision applies; or
- for the purpose of a disclosure requirement occurring before the last date of the period to which the savings provision applies.

The savings provision applies only if the tax position is based on the wording in section EX 1 of the 2004 or 2007 Acts.

Application dates

The amendments apply from the beginning of the 2005–06 income year with both the 2004 and 2007 Acts having been amended to give effect to this application, subject to the savings provisions described above.

Interest deductions for consolidated groups

Section FM 12(2) of the Income Tax Act 2007 has been amended retrospectively to disallow a deduction for interest incurred on money borrowed from another company, when both companies are members of the same consolidated group of companies.

As originally enacted in the 2007 Act, section FM 12(2) allowed a company a deduction for interest incurred on money borrowed from another company within the consolidated group. This was an unintended legislative change, when compared with section HB 2(1)(d) of the 2004 Act, which prevented a company within a consolidated group from being allowed a deduction for interest incurred on money borrowed from another company within the same consolidated group.

Section FM 12 has been amended to ensure that it restores the effect of section HB 2(1)(d) of the 2004 Act.

Excessive remuneration paid by a close company to a shareholder, director or relative

Section GB 25(3) of the Income Tax Act 2007 has been amended retrospectively to ensure that it does not apply to a director, shareholder or a relative of the director or shareholder who is employed substantially full-time and is participating in the administration of the business.

As originally enacted, section GB 25(3) of the 2007 Act permitted the Commissioner to amend the assessment of a director, shareholder or a relative of the director or shareholder, if that person was employed substantially full-time and was participating in the administration of the business. This was an unintended change in outcome when compared to section GD 5 of the 2004 Act.

Section GD 5 of the 2004 Act (which corresponds to section GB 25 of the 2007 Act) did not apply to a director, shareholder or a relative of the director or shareholder who was employed substantially full-time and participating in the administration of the business. The amendment ensures that section GB 25(3) does not apply to a director, shareholder or a relative of the director or shareholder who is employed substantially full-time and participating in the administration of the business

Disposal of trading stock for less than market value

Sections GC 1 and EB 24(1) of the Income Tax Act 2007 have been amended to correct an unidentified change in legislation, as identified by the High Court in *Foodstuffs (Wellington) Co-Operative Society Limited v CIR* (2010) 24 NZTC 23,959 (CIV 2009-485-1224). Section GC 2(3) has been consequentially amended to update the cross-reference to the correct subsection in section GC 1. The amendments are retrospective to the commencement of the 2007 Act.

In the High Court decision of *Foodstuffs (Wellington) Co-Operative Society Limited v CIR*, France J identified that section GC 1 of the 2007 Act contained an unintended change in legislation.

The particular issue before the Court was whether the market value of shares (held as trading stock), which were cancelled on an amalgamation, was income of the shareholder. The Court held that section GD 1 of the 1994 Act (which corresponds to section GC 1 of the 2007 Act) applied and the market value of the shares was income of the taxpayer.

The taxpayer's argument was that section GD 1 required a recipient before it could apply. The Court rejected that argument, holding that section GD 1 did not require a recipient, noting that the section could apply to a sole trader who withdrew trading stock from the business for private consumption, which also did not require a recipient to be a separate person.

As originally enacted in the 2007 Act, both sections GC 1 and EB 24(1) apply to a disposal of trading stock for less than market value by one person to another person.

Section GC 1 has been retrospectively amended to ensure that the sections do not require a recipient of the trading stock, as held by the High Court in relation to the corresponding provision in the 1994 Act (section GD 1 of the 1994 Act).

Section EB 24(1) has been consequentially amended as this provision stems from the same policy background as section GC 1 and contains the same unintended legislative change as was identified by the Court in relation to section GC 1.

Application date

The amendment applies from the beginning of the 2008–09 income year. As the High Court released its decision on 28 October 2009, the amendment includes a savings provision to protect taxpayers who have taken a tax position on the basis of the wording of section GC 1 or EB 24(1) in a return of income filed before 28 October 2009.

Qualifying companies and exempt income

Section HA 1(1)(a) of the Income Tax Act 2007 has been amended retrospectively to replace the term "tax paid" with a phrase that is consistent with the treatment of dividends paid by a qualifying company as being fully imputed or as exempt income.

The phrase "tax paid" in section HA 1(1)(a) was inconsistent with the treatment of a dividend paid by a qualifying company as exempt income. The use of the term "tax paid" might have given rise to an erroneous interpretation.

Section HA 1(1)(a) has been amended to replace the term "tax paid" with wording that is consistent with the treatment of certain dividends paid by a qualifying company as exempt income.

Loss attributing qualifying companies

Section HA 11(4) of the Income Tax Act 2007 has been repealed and its provisions relocated to new section HA 11B. Cross references in section HA 6(2)(c) have been updated.

As enacted in the 2007 Act, the location of section HA 11(4) was capable of being interpreted as not applying to a loss attributing qualifying company. That interpretation would have amounted to an unintended change in outcome when compared with its corresponding provision in the 2004 Act.

Section HG 18 of the 2004 Act provided that a loss attributing qualifying company that ceases to be a loss attributing qualifying company also ceases to be a qualifying company.

The relocation of the provisions of HA 11(4) into section HA 11(4B) ensures that the new provision correctly reflects the effect of section HG 18 of the 2004 Act.

Loss carry forward and loss attributing qualifying companies

Section HA 24(5) of the Income Tax Act 2007 has been amended to ensure that a loss attributing qualifying company is able to carry forward a loss balance arising in an earlier income year in which the company was a qualifying company, but prior to the company becoming a loss attributing qualifying company. Cross references in section IA 7(2) have also consequentially been updated.

Section HA 24(5), as originally enacted in the 2007 Act, incorrectly prevented a loss attributing qualifying company from carrying forward a loss balance arising in income years during which it was a qualifying company and before it became a loss attributing qualifying company.

Section HG 16(1)(c) of the 2004 Act (the corresponding provision to section HA 24(5)) permitted a qualifying company that later became a loss attributing qualifying company to carry forward unused tax losses that arose during the years in which the company was a qualifying company but not a loss attributing qualifying company.

Section HA 24(5) has been amended retrospectively and new subsections HA 24(5B) and (5C) inserted to correct this unintended change by restoring the effect of section HG 16(1)(c) of the 2004 Act.

Loss attributing qualifying companies

Section HA 26 of the Income Tax Act 2007 has been retrospectively amended to permit a shareholder in a loss attributing qualifying company to elect, in the same circumstances provided for in section HG 16(2) of the Income Tax Act 2004, to defer the transfer of the net loss of a loss attributing qualifying company to the shareholders of the company.

Section HA 26 of the 2007 Act did not permit a taxpayer to elect, in certain circumstances, to defer the transfer of the net loss of a loss attributing qualifying company to shareholders of the company. This right of election existed in the corresponding provision to section HA 26 (section HG 16(2) of the 2004 Act).

Under section HG 16(2), a shareholder could have elected to defer the transfer of a loss attributing qualifying company's net loss to shareholders to the following tax year. This election could have been made if the company's tax balance date was later than the electing shareholder's tax balance date and the difference in balance dates meant that waiting for the information could cause the shareholder to file their return of income later than the due date.

Section HA 26 has been retrospectively amended to restore the effect of section HG 16(2) of the 2004 Act.

Tax credits of trustees

As originally enacted in the 2007 Act, section HC 24(2) prevented a trustee from using any tax credits to satisfy its income tax obligations.

The Rewrite Advisory Panel agreed with a submission that this was an unintended change as the 2004 Act did not prevent a trustee from using imputation credits (or other credits under Part L of the 2004 Act) to satisfy its income tax liability in relation to trustee income. The restriction on the use of tax credits in the 2004 Act was to prevent the trustee from obtaining personal tax credits, such as the low income earner rebate and the rebate for charitable donations.

Section HC 24(2) has been amended to ensure that a trustee may use tax credits, such as imputation credits, to satisfy the trustee's income tax liability in relation to trustee income.

The amendment also ensures that section HC 24 continues to prevent a trustee from using a tax credit referred to in either subpart LC or subpart LD.

Commonality of shareholding for groups of companies and tax losses

Section IC 3(3) of the Income Tax Act 2007 has been amended retrospectively to ensure that the commonality of shareholding rules are not applied in a similar manner to the shareholder continuity rules.

Section IC 3(3) of the 2007 Act contained an unintended legislative change, in that a company had to satisfy certain shareholding requirements from the time a tax loss component arose until the tax loss component was used to offset tax losses against another company in the same group. This represented an unintended change in outcome when compared with the corresponding provisions in section IG 1(2) of the 2004 Act.

In section IG 1(2) of the Income Tax Act 2004, a group of shareholders was required to have at least a 66% common shareholding interest in both companies for each tax year, from the tax year the tax loss arose until the loss is offset. Provided there was at least the 66% common interest

between the two companies for each year, it did not matter if the group of shareholders was different in one year from another due to transfers of shareholding.

However, in the 2007 Act section IC 3(3) required the lowest common shareholding after a change in shareholding to be taken into account in determining whether the 66% common shareholding threshold was breached in tax years before that change in shareholding.

Section IC 3(3) has been retrospectively amended to restore the effect of section IG 1(2) of the 2004 Act.

Loss carry-forward and grouping: bad debts and share losses

Section IC 12 of the Income Tax Act 2007 has been amended retrospectively to permit a company to carry forward tax losses arising from bad debts or share losses from one year to another, and then use that carried forward loss to offset against the company's own net income for that later income year.

As originally enacted in the 2007 Act, section IC 12 incorrectly prevented a company from carrying forward tax losses and offsetting those losses against its own net income for a later income year. This outcome differed from the outcome under section IG 2(6) of the 2004 Act.

Section IG 2(6) of the 2004 Act prevented a company from grouping tax losses that arose from bad debts or share losses if the financing of the debt or shares was provided by a group company. However, section IG 2(6) did not prevent the company from carrying forward those losses for use against its own income in future income years.

Section IC 12 has been amended retrospectively to restore the effect of section IG 2(6) of the 2004 Act.

Carrying forward losses and part-year rules

Section IP 5 of the Income Tax Act 2007 has been amended retrospectively to ensure that in a year in which a company breaches the shareholder commonality or continuity requirements, section IP 5(2) does not prevent the company's tax losses from earlier tax years being carried forward to the year in which the breach of commonality or continuity occurs.

Section IP 5 of the 2007 Act incorrectly prevented a company from carrying forward tax losses to a year in which either of the commonality or continuity of ownership rules are breached.

Under the corresponding provisions of the 2004 Act (sections IG 2(2)(b)–(f), (5)), in a part-year situation, a company was permitted to carry forward tax losses arising in one tax year to the next tax year, provided the company satisfied both of the commonality and continuity of ownership rules. Unused tax losses carried forward could then be carried forward to the succeeding tax year or years, until the benefit of those tax losses are fully utilised. For a year in which a company breached the commonality or continuity requirements, tax losses arising from earlier years may be carried forward to the year of breach and the benefit utilised for the part-year before the breach.

Section IP 5 has been amended retrospectively to restore the effect of the corresponding provisions of the 2004 Act.

Tax credits – absentees

Sections LC 3(1) and LC 6(1) of the Income Tax Act 2007 have been amended to make it easier for taxpayers to understand that neither the child income tax credit (section LC 3) nor the housekeeping tax credit (LC 6) are available for a person who is an absentee for income tax purposes.

To obtain the child income tax credit, the child must be in attendance at school for the tax year, and so this tax credit is inherently not available for an absentee. The amendment to section LC 3 states explicitly that the tax credit is not available for an absentee.

Section 41A of the Tax Administration Act 1994 prevents an absentee from receiving the housekeeper tax credit. The amendment to section LC 6 states explicitly that the tax credit is not available for an absentee.

Maximum amount of total deduction for a supplementary dividend holding company

Section LP 10(1) of the Income Tax Act 2007 has been amended to correct an unintended change in the formula in section LP 10(1), in which the parameter "company's income" was incorrectly included in the numerator in the formula. This formula is used to calculate the annual total deduction for an income year of a supplementary dividend holding company.

The amendment ensures that section LP 10(1) correctly reflects the effect of the formula given in the corresponding provision of the 2004 Act (section LE 4(2)).

Application date

The amendment applies from the beginning of the 2008–09 income year. A savings provision applies to protect taxpayers from being adversely affected by the retrospective change, if the taxpayer has relied on the wording of the formula in section LP 10(1) of the 2007 Act in taking a tax position in a return of income filed before the last date of the period for which the savings provision applies.

Timing of imputation credits and debits – tax pooling

The Rewrite Advisory Panel agreed with a submission that section OB 6 of the Income Tax Act 2007 contained an unintended change in law. The Panel considered that the change produced a different timing for the imputation credit on the transfer of an entitlement to funds in a tax pooling account, when compared to the outcome given by section ME 4(2)(ad) of the 2004 Act.

The Panel also noted that consequential amendments would be required for related imputation (tax pooling) provisions (sections OB 34, OB 35, OP 9, OP 32, and OP 33).

The purpose of "tax pooling" is to provide a pool of funds for use by companies to reduce exposure to use-of-money interest and late payment penalties – in particular, for provisional tax. A tax pooling intermediary administers the tax pooling account, including a transfer (when requested) of funds to a taxpayer's tax account with Inland Revenue.

Under the tax pooling rules, if a taxpayer pays an amount for tax into a "tax pooling account", that payment is held in trust for that taxpayer's benefit. Funds held for the benefit of a taxpayer in a tax pooling account are normally described as an entitlement to funds in the tax pooling account.

However, taxpayers may "sell" their entitlement to funds in a tax pooling account to another taxpayer. On that sale, the tax pooling intermediary transfers the entitlement to those funds to the other taxpayer.

Under the tax pooling imputation rules, a company is intended to have a credit in its imputation credit account (ICA) for:

- a payment for tax made into the tax pooling account (that is, the taxpayer's own deposits into the tax pooling account);
- the purchase of an entitlement to funds in a tax pooling account.

It is also possible that a purchaser of an entitlement may, instead of transferring the underlying funds to the purchaser's tax account with the Commissioner:

- later on-sell that entitlement to another taxpayer; or
- later request that the intermediary refunds to the purchasing company the funds representing that entitlement from the tax pooling account.

The tax pooling imputation rules provide specific timing rules for the imputation credit that relates to a deposit of funds or purchase of funds. These timing rules are necessary to ensure consistency with the overall objectives of:

- the tax pooling rules;
- enabling the benefit of tax paid at the corporate level to be available for shareholders; and
- the rules relating to the transfer of other tax types to a taxpayer's income tax account with Inland Revenue.

The timing of imputation credits arising in relation to an entitlement to funds in a tax pooling account is as follows:

- The date of the imputation credit for a deposit into a tax pooling account is the date of the deposit. If an entitlement to funds is on-sold, the vendor company must debit its ICA for the amount of the entitlement sold.
- For a purchased entitlement, the date of the imputation credit for a purchased entitlement to funds in a tax pooling account is permitted to be backdated if the funds are transferred to the company's tax account with Inland Revenue. The backdating of the credit is to a date selected by the taxpayer, but can be no earlier than the date of the original deposit made to the tax pooling account. Some restrictions also apply to the backdating to prevent abuse of the backdating rule.
- The date of the imputation credit for a purchased entitlement to funds in a tax pooling account that is on-sold (transferred) to another taxpayer is the date of the transfer. A debit to the company's imputation credit also arises for the amount on-sold on the transfer, because the purchased amount is not transferred to the company's tax account with Inland Revenue and therefore does not represent tax paid by the company.
- The date of the imputation credit for a purchased entitlement to funds in a tax pooling account that is refunded to the company from the tax pooling account is the date of the refund. A debit to the company's imputation credit also arises for the amount on-sold, because the purchased amount is not transferred to the company's tax account with Inland Revenue and therefore does not represent tax paid by the company.

Detailed analysis

Section OB has been amended to ensure that a company acquiring an entitlement to funds in a tax pooling account receives an imputation credit, and that the date of the credit is as follows:

- if the purchasing company requests the intermediary to transfer to the company's tax account with Inland

Revenue, an amount representing an entitlement to the funds in the tax pooling account, the date of the credit is determined under the effective date rules in sections RP 19 and RP 20; or

- if the purchasing company on-sells to another taxpayer that entitlement to the funds in the tax pooling account, the date of the credit is at the date the entitlement is transferred to the other taxpayer; or
- if the purchasing company requests that the intermediary refunds the funds representing the purchased entitlement from the tax pooling account to the company, the date of the credit is the date of the refund.

Consequential amendments to other imputation (tax pooling) provisions

In addition:

- As originally enacted in the 2007 Act, section OB 34 applied only to a company in relation to a deposit of its own funds in a tax pooling account. Section OB 34 has been amended to ensure that it applies to a company that has purchased an entitlement to funds in a tax pooling account.
- As originally enacted, section OB 35 applied only to an on-sale of an entitlement that was deposited by the selling company. Section OB 35 has been amended to ensure that it applies to an on-sale of an entitlement to funds in a tax pooling account that a company had previously purchased from another company.
- As originally enacted, section OP 9 contained the same drafting concerns set out above, and has been amended in the same way as section OB 6.
- As originally enacted, section OP 32 and OP 33 were drafted differently from the language in sections OB 34 and OB 35. Sections OP 32 and 33 have been amended to ensure they are drafted to be consistent with the amendments for sections OB 34 and OB 35.
- Section OP 33 has been amended to clarify that the tax pooling intermediary is the person that transfers entitlements to funds in a tax pooling account, as the trustee of those funds.

Imputation debit breach of continuity adjustment

Section OB 32(2)(b) of the Income Tax Act 2007 has been amended retrospectively to ensure that the debit to an imputation credit account for a breach in shareholder continuity is correctly adjusted if the company has also received a debit to its imputation credit account for income tax refunded to the company before the breach in shareholder continuity occurred.

The Rewrite Advisory Panel agreed with a submission that section OB 32(2)(b) of the 2007 Act contained an unintended change in law. Section OB 32 provided for an adjustment to the debit to a company's imputation credit account (ICA) for a refund of income tax if that refund has also been included in the calculation of the debit for a breach of continuity.

On a breach of shareholder continuity, the company's imputation credit account (ICA) is debited for the amount of imputation credits for which shareholder continuity is not satisfied. However, as income tax refunded prior to a debit for breach of shareholder continuity also gives rise to a debit to the ICA, section OB 32(2)(b) adjusts the debit for breach of shareholder continuity to take into account the earlier debit for a refund of income tax, in this way preventing two debits to the ICA for the same imputation credit.

The unintended change in law limited the adjustment to a debit for breach of continuity for income tax refunded prior to the breach, to an amount that is less than the debit for the breach in continuity. In the corresponding provision in the 2004 Act (section ME 5(1)(e)), the adjustment amount could be less than or equal to the debit for the breach in continuity.

Payments by RWT proxies

The definition "tax rate" in section RE 18(2) of the Income Tax Act 2007 has been amended to refer to clause 3 of clause 2, of schedule 1, part D. This amendment corrects the incorrect cross-reference to clause 2 of schedule 1, Part D.

Definition of "revenue account property"

The Rewrite Advisory Panel considered the drafting of the definition of "revenue account property" in the Income Tax Acts 2004 and 2007 were ambiguous as they could be read as requiring a factual test to be applied.

The consequence of that interpretation was that property that became valueless, despite initially coming within the meaning of "revenue account property", would no longer be "revenue account property". The Panel was concerned that the cost of the property might then not be deductible as a result of the property's loss in value.

The amendment clarified the definition of "revenue account property" in both the 2004 and 2007 Acts to ensure that that if "revenue account property" becomes valueless, it does not cease to be revenue account property.

This amendment ensures that the cost of revenue account property that becomes valueless may still be deductible under the general permission and allocated to the

appropriate income year under section EA 1 (Trading stock) or section EA 2 (Other revenue account property).

Application dates

The amendment applies from the beginning of the 2005–06 income year (both the 2004 and 2007 Acts have been amended to give effect to this application).

Currency conversion rules

The amendment to section YF 1 codifies the Commissioner's practice of permitting alternative currency conversion methods and alternative rates to the actual exchange rates at the time a transaction occurs. This administrative practice permitted alternative rates or currency conversion methods to that stipulated in the Privy Council's decision in *Payne v The Deputy Federal Commissioner of Taxation* [1936] AC 497; [1936] 2 All ER 793.

This practice was adopted to reduce compliance costs for taxpayers, given the decision in *Payne*, that currency conversions should be made at the actual exchange rate at the time of the transaction, unless otherwise provided by statute.

Under the Income Tax Act 2004 and earlier legislation, some provisions of the Act had explicit currency conversion rules (in particular the controlled foreign company and foreign investment fund rules). However, apart from those specific rules, the Act was silent on methods of conversion.

When rewriting the currency conversion rules into the 2007 Act, section YF 1 incorporated the effect of the decision of the Privy Council in *Payne*.

The effect of that decision is that, in calculating taxable income, amounts derived in a foreign currency should be converted at the rate of exchange applying at the time of the transaction, unless the legislation otherwise provided.

The effect of section YF 1 of the 2007 Act, as originally enacted arguably prevented the Commissioner from continuing the extra-statutory practice of permitting alternative rates or currency conversion methods.

The amendment to section YF 1 and the insertion of section YF 2 legislate for the administrative practice of the Commissioner. Together these two provisions permit the Commissioner to approve taxpayer-specific methods or rates, as well as general methods or rates.

Definition of "cultivation contract work"

In schedule 4, part C, clause 2 of the Income Tax Act 2007, the definition of "cultivation contract work" has been amended to clarify that the schedular payments rules only apply to works or services provided under a contract or arrangement for the supply of labour, or substantially for the supply of labour in relation to land that is intended to be used for the cultivation of fruit crops, vegetables, orchards or vineyards.

The effect of the amendment ensures that tax is to be withheld at source (under the PAYE rules) from payments for cultivation contract work that are for labour-only services, or substantially labour-only services. This amendment ensures that the definition does not include payments for services that involve a high capital element such as the use of a combine harvester.

Application date

The amendment applies from 1 April 2010.

Exemption certificates

The amendment corrects section 24M(5) of the Tax Administration Act 1994, as recommended by the Rewrite Advisory Panel. The Panel's concern was that section 24M(5) could be read as being in conflict with section 24M(1), effectively negating the use of an exemption certificate issued under section 24M(1). This exemption certificate relieves the payer of schedular payments of the obligation to withhold tax from the payment.

Section 24N(5) is consequentially amended, as it contains a similar ambiguity.

The amendments to both sections 24M and 24N ensure that:

- subsection (5) in each provision does not override the effect of subsection (1), to prevent a zero rate of withholding from being applied to schedular payments; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act 1994, if the person alters an exemption certificate or special rate certificate issued by the Commissioner in relation to schedular payments; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act 1994, if the person uses or attempts to use an exemption certificate, that has expired or been cancelled by the Commissioner, to obtain a zero rate of withholding from schedular payments made to the person; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act 1994, if the person uses or attempts to use a special tax rate certificate, that has expired or been cancelled by the Commissioner, to obtain a rate of withholding for schedular payments less than the rate set out in Schedule 4, Part C, clause 1(b) of the Income Tax Act 2007.

Minor maintenance items referred to the Rewrite Advisory Panel

The following minor maintenance items were referred to the Rewrite Advisory Panel.

The term "amount of tax" in subpart RM is ambiguous as to whether it includes income tax for the purpose of the refund rules. The amendment removed the ambiguity.

The amendment to section 52(a) of the Tax Administration Act 1994 corrects a drafting error in the consequential amendment in schedule 50 of the Income Act 2007.

For drafting consistency, section CW 31(3) has been inserted into schedule 22A to ensure that the schedule refers to section CW 31(3) and section CW 32(3), as both sections are drafted in the same manner.

These amendments have been referred to the Rewrite Advisory Panel as minor maintenance items and retrospectively correct any of the following:

- ambiguities;
- compilation errors;
- cross-references;
- drafting consistency, including readers' aids, for example the defined terms lists;
- grammar;
- punctuation;
- spelling;
- subsequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

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.

COMMISSIONER PARTIALLY SUCCESSFUL ON APPEAL

Case	Chesterfields Preschools Limited v Commissioner of Inland Revenue
Decision date	31 August 2010
Act(s)	Judicature Amendment Act 1977, Tax Administration Act 1994
Keywords	Remission, arrangement, care and management, costs, freezing orders

Summary

The Commissioner successfully appealed three decisions of the High Court and had a partial success of a fourth appeal. He received directions from the Court of Appeal for the steps necessary to satisfy the earlier orders of the High Court.

Impact of decision

The decision is a mixed result for the Commissioner. While he is required to redo some aspects of earlier decisions, other aspects were upheld. It is helpful to have the Court's views on what should be done to remedy the Commissioner's mistakes and the Court's view that the mistake did not originate from a deliberate attempt to not give effect to the High Court's first judicial review judgment (as found in the second judicial review judgment).

Of particular interest is the Court's express statement confining the litigation to its facts.

The Commissioner will not appeal any part of the decision where he was unsuccessful.

Facts

The taxpayers and the Commissioner have been in protracted dispute on a number of legal fronts.

Following a first judicial review (1JR: reported (2007) 23 NZTC 212,125) and after several months of consideration the Commissioner made a series of decisions to give effect to that first judicial review. Those decisions are referred to as the Budhia decision.

The taxpayers were dissatisfied with the outcome of those decisions and commenced a further judicial review (2JR: reported (2009) 24 NZTC 23,148). This second judicial review concluded that the Commissioner had failed to give effect to the 1JR and that he was required to re-do the exercise.

The Commissioner appealed the 2JR on the basis that he had given full effect to the 1JR.

In addition there were three other appeals (all brought by the Commissioner) considered by the Court. Two of these related to the taxpayers' attempt to vary orders restraining their ability to further encumber their assets to the Commissioner's disadvantage. At two separate times, the High Court authorised the further encumbering of those assets. Both times the Commissioner successfully obtained an order of the Court of Appeal freezing the execution of the High Court decision. The substantive appeal from the variation decisions was heard with the 2JR appeal.

Additionally the High Court's costs orders in the 1JR and 2JR against the Commissioner were appealed on the basis these were excessive (reported (2009) 24 NZTC 23,504).

Decision

The Court pointed out that the 1JR had not been appealed and thus binds the parties on its findings. Nonetheless, 1JR was held not to be precedential in any way.

The court concluded that the Commissioner had complied with the 1JR only in part. To a degree the Budhia decision was upheld (regarding issues of GST registration and challenges to GST returns) but the balance was struck down (the relief from interest and penalties where these were attributable to the Commissioner's inordinate delay).

The Court considered that section 6/6A was available for the Commissioner to mitigate the effects of "inordinate delay" as this case was extraordinary. The Court gave several alternatives as to what should happen next to resolve this case.

The Court rejected any suggestion that "proportionality" is a legal concept in judicial review.

The Court allowed the Commissioner's appeal against the costs decisions of the High Court and the appeals against varying the Commissioner's security.

JG RUSSELL UNSUCCESSFUL IN APPEAL OF HIS PERSONAL TAX ASSESSMENTS

Case	John George Russell v Commissioner of Inland Revenue
Decision date	03 September 2010
Act(s)	Income Tax Act 2007, Tax Administration Act 1994
Keywords	Russell template, personal exertions

Summary

An appeal by the taxpayer from a Taxation Review Authority (TRA) decision had been rejected by the High Court. Assessments based upon tax avoidance have been reconfirmed.

Impact of decision

The decision is no surprise given the clear tax avoidance purpose or effect of the arrangement.

The taxpayer has filed a further appeal in the Court of Appeal.

Facts

This was an appeal from the TRA (*Case Z19* (2009) 24 NZTC 14,217).

The taxpayer was the designer and promoter of the "Russell template" tax avoidance scheme. This case addressed his personal tax affairs from 1985 to 2000. It has little to no relationship with the template litigation.

Mr Russell had earned income through his personal exertions including, but not confined to, the sale of the Russell template. Originally a sole trader, he had entered into a partnership structure using two companies that he controlled to create the Commercial Management Partnership. The income earned by Mr Russell's activities was attributed to the partners. Throughout the life of the partnership new partners would be introduced to replace old ones.

In addition the partners individually would enter agency and management agreements with tax loss companies. The tax losses companies were controlled by Mr Russell. The partners would account to the loss companies for any income earned and that income would be sheltered by the loss in the loss company. As the tax losses of any particular company were used up, a new tax loss company would be substituted in (using agency and management agreements). The cash would, however, be "banked" with finance companies controlled by Mr Russell.

The TRA concluded that the structure was tax avoidance and that Mr Russell was a person affected by it (under section BG1 and its predecessor section 99), confirming the Commissioner's reconstructive assessments to Mr Russell personally.

The taxpayer appealed the TRA decision on all points but at the High Court abandoned most of the points taken and confined the appeal to three main points.

In summary those points were that if there was an arrangement then it was properly confined to that between the partner companies and the tax loss companies (the agency and management agreements) and not the wider arrangement the Commissioner argued for. If the taxpayer was correct then there was no rationale to reconstruct to Mr Russell personally.

Decision

Relying upon *Ben Nevis*, Justice Wylie had little difficulty finding the existence of an arrangement. He rejected the narrow arrangement contended for by the taxpayer in favour of the Commissioner's wider arrangement, primarily because of Mr Russell's complete control of the entire structure.

The Judge relied upon the recent Court of Appeal decision in *Penny & Hooper v CIR* to agree that, while the taxpayer had used legitimate corporate, partnership and trust structures, the Commissioner was entitled to challenge the way those structures were employed. The arrangement did alter the incidence of tax, it was contrived, and involved pretence.

His Honour concluded that there was a tax advantage: firstly by Mr Russell divesting himself of personal exertions income into the structure and then, secondly, by the use of the tax loss companies to shelter that income.

The Judge rejected a submission by the taxpayer that he received no tax advantage as he did not receive any money from the arrangement, observing that this was not the test. The proper test was whether there was a tax advantage and the arrangement did confer a tax advantage on Mr Russell (by divesting him of his personal exertions income and then avoiding tax on that income).

SALE OF SHARE IN A COMPANY WHICH GIVES RIGHT TO A LEASE IS NOT A GOING CONCERN

Case	Tepe Holdings Ltd v Commissioner of Inland Revenue
Decision date	13 September 2010
Act(s)	Goods and Services Tax Act 1985
Keywords	Going concern

Summary

The Court held that the true nature of the sale was a sale of shares and not of tenanted property. Therefore, the taxpayer's claim of a supply of a going concern of a tenanted property failed.

Impact of decision

There are no implications as the case turns largely on its own facts.

The taxpayer has filed an appeal in the Court of Appeal.

Facts

Tepe Holdings Ltd ("THL") acquired a right of occupation of the fourth floor ("Fourth Floor") in the building known as "Central House" at 26 Brandon Street, Wellington, which was let to two tenants on a monthly tenancy basis. THL acquired the right of occupation by purchasing shares in Central House Ltd ("CHL").

On 2 March 2007, THL entered into an agreement with Okato Management Ltd ("OML") to sell and buy the property described as: "exclusive occupation rights to the Fourth Floor of the building known as Central House, 26 Brandon Street, Wellington being Group E of the shareholding in Central House Limited being 19,750 shares".

The sale of the property was subject to the vendor (THL) giving vacant possession of the Fourth Floor.

On 14 March 2007, OML indicated in a letter to THL that it wished to retain the existing tenants on the Fourth Floor "at least for the moment".

On 15 March 2007, the parties agreed that OML would be "supplanted" by Central Beehive Ltd ("CBL") as the purchaser under the 2 March 2007 agreement.

Decision

The Court held that the true nature of the transaction was the sale of shares in CHL as opposed to sale of tenanted property as claimed by THL because it was the ownership of the shares that provided the right to a lease of the Fourth Floor.

The Court therefore concluded that the provision in the sale agreement about the sale of tenanted property as a going concern was not applicable.

The Court then went on to consider if it was wrong in its view about the true nature of the sale, whether there was sale of tenanted property and the provision in the agreement relating to it applied.

At the heart of the consideration was whether the sale agreement varied to that of sale of tenanted property, as the agreement originally provided that the property be sold with vacant possession.

The Court held that there was a variation of the sale agreement as there was clear evidence that OML/CBL had accepted the existing tenants of the property as part of the sale and accordingly there was a supply of tenanted property.

However, as the Court had decided that the true nature of the transaction was that of sale of shares, THL's claim that its supply was that of a going concern and therefore be zero rated for GST, must fail.

ARRANGEMENT SEEN AS TAX AVOIDANCE

Case	Krukziener v Commissioner of Inland Revenue
Decision date	17 September 2010
Act(s)	Sections 108 and 141 of the Tax Administration Act 1994, TRA case Z23
Keywords	Tax avoidance, loans, repayment

Summary

A property developer lived substantially off "loans" taken from his various companies over a 10-year period. Repayments only occurred after he was audited and only from tax-free capital receipts. In the Taxation Review Authority (TRA) and now in the High Court, the arrangement has been held to be tax avoidance, and the "loans" are in fact, assessable income.

Impact of decision

The structure used in this case had a number of features which meant that, when the arrangement is looked at as a whole, the tax benefits flowing from it were the only explicable reason.

This case is not authority for invoking the anti-avoidance provision simply because a taxpayer takes a loan in lieu of a salary, though the Commissioner is aware there are a number of taxpayers (particularly property developers)

using a similar structure who will be affected by this decision. In each case, as with any tax avoidance inquiry, it will be a matter of examining the arrangement to determine the tax effects which flow from it, and the commercial rationale for implementing it.

The taxpayer has filed an appeal in the Court of Appeal.

Facts

The taxpayer is a property developer who operated his businesses through a series of trusts. Each property development project was undertaken through a trading trust set up for that purpose. Most of the developments were successful, and as each development finished, the profits from it were distributed from the trust to another trust in the "group". That other trust was in a loss position at that stage, as the development for which it was set up was in its "start-up" phase. When that second trust eventually turned to profit, the profits were distributed to the next trust, and so on. The effect of this was that none of the trusts were ever required to pay tax; there was always another trust in a loss position that the profits could be distributed to.

The taxpayer operated this structure between 1991 and 2002. During this period the taxpayer returned very little income. However, he received net funds of over $5 million from the "group" by way of loans, which were used to meet his everyday living expenses. The loans were repaid by way of a capital distribution once the Commissioner's investigation had begun.

The Commissioner took the view that the arrangement was void as tax avoidance and reconstructed the loans as income to the taxpayer. Shortfall penalties for abusive tax position were also imposed.

The taxpayer challenged the assessments in the TRA *Case Z23* and lost. He appealed to the High Court.

Issues

1. Is the arrangement tax avoidance?

1.1 Was there an arrangement?

The taxpayer argued that there could be no arrangement as some of the steps were not, and could not have been, contemplated at the time the structure was created. To hold there was an arrangement would be to tax retrospectively and would offend the rule of law.

The taxpayer further challenged the TRA's finding that there were separate arrangements in each of the tax years. Taxpayers must be able to determine, at the end of each year, their tax liability for that year.

1.2 Was the purpose and effect of the arrangement tax avoidance?

The taxpayer argued that the loans were genuine liabilities that were always intended to be, and were, repaid, and that the TRA had erred in holding that a receipt had to be either income or capital. In this case the receipts were neither; they were loans.

The taxpayer asserted that there was no requirement to take a salary from the trusts, relying on *Penny & Hooper* (CA).

1.3 Was tax avoidance merely incidental?

The taxpayer argued there was a legitimate commercial rationale for using the structure.

2. Were some years time-barred under s 108 of the Tax Administration Act 1994?

The taxpayer argued that the assessments for the earlier tax years were time-barred under s 108 of the Tax Administration Act 1994 (TAA) as more than four years had passed since the end of the period in which the relevant return was filed.

3. Were penalties correctly imposed?

The taxpayer argued that the tax positions taken were tenable, and could meet the standard of being about as likely as not to be correct.

The taxpayer also argued that the tax position taken should be offset against deductions allowed to related entities under s 141(7) of the TAA.

Decision

The Commissioner won on all issues.

Arrangement

Her Honour held that the evidence showed there was a plan that the taxpayer would not repay advances unless there was a (tax free) capital distribution available. Her Honour also held that the TRA's conclusion that there was more than one arrangement was inevitable.

Purpose or effect of tax avoidance and commercial rationale

In responding to the taxpayer's contention that there were practical commercial reasons for not paying a salary from the trusts, Her Honour analysed the Court of Appeal decision in *Penny & Hooper* and held at [42] that:

> It may be that the proprietor of a property development business would, for the reasons that Mr Krukziener gave in evidence, be justified in accepting a salary below market or even no salary at all pending the completion of the project. So, in principle, Mr Lennard's submission stands, notwithstanding the Court of Appeal's decision. However,

> there is an obvious question on the facts of this case as to why Mr Krukziener would not have received any income over such a long period.

The taxpayer's submission that he was building towards a significant project which would leave him with tax to pay was rejected on the facts, and Her Honour went on to note that even if that was the case, the deferral of tax for such a long period would have the effect of tax avoidance. Her Honour went on to note:

> Where the proprietor of a business has expended time and effort on a project, and incurred debt waiting for the project to be completed, and the project is completed at a profit, there would seem to be no legitimate reason for some of that profit not to be distributed. The need of the next project for funds does not preclude such distribution since it is always open to the proprietor of the business to advance funds for the next project. In the circumstances of this case, therefore, I do not accept that the level of income provided to Mr Krukziener over such a long period can be regarded as legitimate.

Her Honour accepted that there was a commercial reason for not making distributions to the taxpayer from the profits of the trusts, being to leave the taxpayer in debt as a defensive strategy. However, Her Honour did not put much weight on this rationale.

Her Honour accepted the Commissioner's argument that, from the trusts' perspective, lending money to the taxpayer interest-free while borrowing elsewhere at commercial rates, pointed to an absence of commerciality.

In summary, Her Honour stated:

> Against these various disadvantages, the tax benefits of the arrangement stand out clearly. Notwithstanding the asserted rationale, the effect of the arrangement was clearly tax avoidance, at least in the sense of deferring the tax obligation. Over more than a decade during which more than 80, mostly profitable, projects were completed under Mr Krukziener's stewardship, he received more than $5 million net to cover his living expenses on which no tax was paid. He repaid most of that from capital receipts on which no tax was payable and the balance has never been repaid. Nor was interest paid until 2001, by which time Mr Krukziener was aware that his tax affairs were to be investigated. Looking at the overall benefits of the arrangements to Mr Krukziener, it is apparent that the protection offered by the debt had much less effect in commercial terms than the deferment or avoidance of income tax.

Time bar

Her Honour followed the Privy Council decision in *Miller v CIR* which held that although reconstructed income is deemed to be derived, the nature and source of the deemed income does not change. In this case, that nature and source was loans from the trusts. These were not disclosed, so the time bar did not apply.

Shortfall penalties

Her Honour held that the tax benefits from the arrangement stood out as being the dominant purpose, and therefore the standard of "about as likely as not to be correct" could not be met.

Her Honour noted that as the taxpayer had been found to have taken an abusive tax position, set-off under s 141(7) of the TAA was not available, by virtue of s 141(7B).

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