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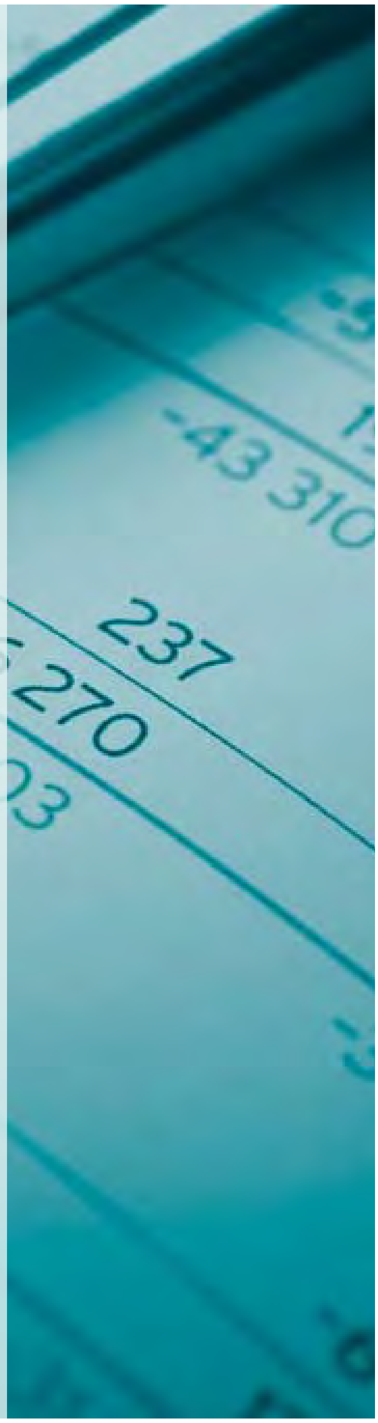

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YOUR OPPORTUNITY TO COMMENT

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
SPS ED0122	Acceptance of late objections under section 92(2) of the Child Support Act 1991	This draft SPS sets out Inland Revenue's policy on the acceptance of late objections to assessments or decisions under section 92(2) of the Child Support Act 1991. This SPS will replace SPS INV-300 *Acceptance of late objections under section 126 of the Tax Administration Act 1994* which was withdrawn last year.	30 June 2010
ED0125	Equestrian arenas consisting of permanent construction materials (excluding base course) – Depreciation	The Commissioner intends to set a provisional economic depreciation rate for equestrian arenas consisting of permanent construction materials (excluding base course).	30 June 2010

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Binding rulings

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This ruling is a re-issue of public ruling BR Pub 05/14, which expired on 31 December 2008. It considers the meaning of "on liquidation" in the context of short form liquidations under the Companies Act 1993, ie when a company requests removal from the register of companies; section 318(1)(d).

Public rulings BR Pub 10/07: Commissions received by life agents on their own policies and those of associated persons – income tax treatment; and BR Pub 10/08: Discounted premiums on life insurance policies provided to life agents and associated persons – fringe benefit tax implications 8

These rulings consider the income tax treatment of commissions received by life agents on their own life insurance policies and associated persons, and the fringe benefit tax treatment of discounted life insurance policies received by life agents and associated persons. They are re-issues of public rulings BR Pub 00/01 and BR Pub 00/02, which expired on 31 December 2004.

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Double Tax Agreement on pensions not discriminatory 48

The Taxation Review Authority struck out the taxpayer's complaint of possible discrimination on jurisdictional grounds, but cancelled the shortfall penalties which had been imposed by the Commissioner.

Struck-off company has no legal capacity 49

A struck-off company has no legal status and cannot appear before the Taxation Review Authority (TRA); regardless of this, on the facts as found by the TRA there was no issue to address.

Commissioner's right to withhold payments 50

The Court did not exercise its jurisdiction to grant relief to the taxpayer's judicial review application. The Court held that the Commissioner was not yet satisfied with the goods and services tax (GST) return and could continue to withhold payment. The Court also held that although the taxpayer's Notice of Proposed Adjustment (NOPA) was valid and the Commissioner should have issued a Notice of Response (NOR), as the contract to which it related had been cancelled, relief was not granted.

Questions we've been asked

QB 10/03: Fringe benefit tax – Value of motor vehicle previously owned by the employer or by an associated person of the employer 52

This item discusses when the value of a motor vehicle for fringe benefit tax purposes will be affected by the vehicle having previously been owned by the employer or an associated person of the employer.

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**

PUBLIC RULING BR PUB 10/06: MEANING OF "ANYTHING OCCURRING ON LIQUIDATION" WHEN A COMPANY REQUESTS REMOVAL FROM THE REGISTER OF COMPANIES

Note (not part of ruling): This Ruling is a re-issue of Public Ruling BR Pub 05/14, which was first published in *Tax Information Bulletin* Vol 17, No 10 (December 2005). BR Pub 05/14 applied until 31 December 2008. This Ruling is essentially the same as BR Pub 05/14, but has been updated for the Income Tax Act 2007, which came into force on 1 April 2008.

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

Taxation Laws

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

This Ruling applies in respect of paragraph (b)(i) of the definition of "liquidation" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the liquidation of a company when a request is made under section 318(1)(d) of the Companies Act 1993 that the company be removed from the New Zealand register of companies.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

The first step legally necessary to achieve liquidation when a request is made to the Registrar of Companies to remove a company from the New Zealand register of companies under section 318(1)(d) of the Companies Act 1993 is a resolution by the shareholders or board of directors or, where applicable, another overt decision-making act provided for in a company's constitution to adopt a course of action that will end in removal from the register. That first step starts the period specified in paragraph (b)(i) of the definition of "liquidation" in section YA 1. Anything done after that first step to enable liquidation occurs "on liquidation" for the purposes of the Income Tax Act.

The period for which this Ruling applies

This Ruling will apply for a five year period beginning on 1 January 2009 and ending on 31 December 2014.

This Ruling is signed by me on the 29th day of April 2010.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 10/06

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 10/06 ("the Ruling").

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

The purpose of this ruling is to clarify the first step legally necessary to achieve liquidation when a request is made to the Registrar of Companies to remove a company from the New Zealand register of companies under section 318(1)(d) of the Companies Act 1993. The conclusion is that the first step is a resolution or another overt decision-making act that is provided for in a company's constitution to adopt a course of action that will end in the removal of the company from the register.

Interpretative issue

1. The Ruling concerns the meaning of the phrase "anything occurring on liquidation" in paragraph (b) of the definition of "liquidation" in section YA 1 when a request for removal from the register of companies is

made under section 318(1)(d) of the Companies Act 1993.

2. The term "liquidation" includes the removal of a company from the register of companies. The removal of a liquidated company from the register occurs under the Companies Act 1993 after the full liquidation process or after the shorter, alternative process provided by section 318(1)(d) of the Companies Act 1993. The alternative process is sometimes referred to as a "short-form liquidation".

3. A short-form liquidation is cheaper and simpler than a full liquidation. A short-form liquidation involves a request for the company's removal from the register by:
   - an authorised shareholder; or
   - the board of directors; or
   - any other person required or permitted to do so by the constitution of the company.

   Such a request can be made to the Registrar of Companies only after the company has paid its debts and distributed any surplus to its members: section 318(2) of the Companies Act 1993.

4. Paragraph (b) of the definition of "liquidation" in section YA 1 prescribes the period during which an action or event will be considered to be occurring "on liquidation". This definition is important because specific tax consequences flow from acts that occur "on liquidation". Paragraph (b) of the definition of "liquidation" provides that the period known as "on liquidation" starts with "a step that is legally necessary to achieve liquidation".

5. Paragraph (b)(i) includes two examples of steps that are legally necessary to achieve liquidation:
   - the appointment of a liquidator; or
   - a request for removal under section 318(1)(d) of the Companies Act 1993.

6. The second example of a step that is legally necessary to achieve liquidation has given rise to uncertainty and is why the Commissioner has issued this Ruling.

7. The issue is whether a request for removal under section 318(1)(d) of the Companies Act 1993 is the first step legally necessary to achieve liquidation. If so, on a short-form liquidation the period known as "on liquidation" will not begin until the request for removal from the register has been made under section 318(1)(d). Under the Companies Act 1993, that request cannot be made until any surplus has been distributed.

8. Such an interpretation would mean that companies that follow the short-form liquidation process may be unable to make tax-free distributions "on liquidation" under section CD 26(2). If a request for removal is the start of the "on liquidation" period then all surplus assets must have been distributed before the request is made. Therefore, the purpose of this Ruling is to determine the correct interpretation of the phrase "anything occurring on liquidation" in the context of a short-form liquidation. In particular, the Ruling considers the meaning of the words "on liquidation".

Conclusion

9. In the Commissioner's view, the phrase "anything occurring on liquidation", in particular the words "on liquidation", refer to a period. That period starts with the occurrence of the first step legally necessary to achieve liquidation. The Commissioner considers that when a removal request is made under section 318(1)(d) of the Companies Act 1993, the first step legally necessary to achieve liquidation will ordinarily be the passing of the resolution to cease business, pay all creditors, distribute surplus assets, and to then request removal from the register. That step starts the period specified in paragraph (b)(i) of the definition of "liquidation" in section YA 1. Anything done after that step to enable liquidation occurs "on liquidation" for the purposes of the Income Tax Act.

10. Therefore, on a short-form liquidation any capital distributions a company makes after the passing of a resolution to enable liquidation will be made "on the liquidation of the company" and may be excluded from being dividends under section CD 26.

Legislation

11. Section YA 1 provides:

    YA 1 Definitions

    In this Act, unless the context requires otherwise,—

    …

    liquidation, for a company,—

    (a) includes—

    (i) removal of the company from the register of companies under the Companies Act 1993; and

    (ii) termination of the company's existence under any other procedure of New Zealand or foreign law; and

    (b) includes, in references in this Act to anything occurring on liquidation, anything occurring—

    (i) during the period that starts with a step that is legally necessary to achieve liquidation, including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993; and

    (ii) for the purpose of enabling liquidation.

12. A request to remove a company from the New Zealand register of companies can be made under section 318 of the Companies Act 1993. Section 318(1)(d) provides:

    (1) Subject to this section, the Registrar must remove a company from the New Zealand register if—

    …

    (d) there is sent or delivered to the Registrar a request in the prescribed form made by—

    (i) A shareholder authorised to make the request by a special resolution of shareholders entitled to vote and voting on the question; or

    (ii) The board of directors or any other person, if the constitution of the company so requires or permits—

    that the company be removed from the New Zealand register on either of the grounds specified in subsection (2) of this section; …

13. Section 318(2) of the Companies Act 1993 sets out the grounds for making such a request:

    (2) A request that a company be removed from the New Zealand register under subsection (1)(d) of this section may be made on the grounds—

    (a) that the company has ceased to carry on business, has discharged in full its liabilities to all its known creditors, and has distributed its surplus assets in accordance with its constitution and this Act; or

    (b) that the company has no surplus assets after paying its debts in full or in part, and no creditor has applied to the Court under section 241 of this Act for an order putting the company into liquidation.

Application of the legislation

14. A request to remove a company from the register of companies under section 318(1)(d) of the Companies Act 1993 can be made by:
    - a shareholder authorised by shareholders' special resolution; or
    - the board of directors; or
    - any other person required or permitted by the constitution to do so.

15. It is clear from section 318(2)(a) and (b) of the Companies Act 1993 that at the time a request for removal is made under section 318(1)(d) of the Companies Act 1993 any surplus assets must have already been distributed.

16. The function of paragraph (b) of the definition of "liquidation" in the Income Tax Act is to set out the period when anything may occur on liquidation. Subparagraph (i) of paragraph (b) defines the period. The beginning of the period is most important and starts with "a step that is legally necessary to achieve liquidation". This puts the focus on the first steps. Subparagraph (ii) limits the "anything occurring on liquidation" to things occurring within that period that are for the purpose of enabling liquidation. Things that occur for another purpose will not occur "on liquidation".

What is meant by "a step that is legally necessary to achieve liquidation"?

17. The phrase "a step that is legally necessary to achieve liquidation" distinguishes between:
    - steps that are legally necessary and any other steps; and
    - steps that are to achieve liquidation and steps that are taken for another purpose.

18. The ordinary meaning of the word "step" implies an "action". Therefore, the focus is on overt acts rather than, for example, the existence of circumstances or beliefs.

19. Some steps necessary to achieve liquidation in practice may not be legally necessary. For example, a step that is necessary in practice for a liquidation by special resolution of shareholders is to decide who the liquidator will be. That decision is not a legally required step even though it must have occurred. The closest legally necessary step would be appointing the liquidator or obtaining the liquidator's written consent to appointment.

20. The words "to achieve liquidation" further narrow the range of steps that can start the period. Some steps legally necessary to achieve liquidation may be taken for a purpose other than to achieve liquidation. For example, paying all creditors is necessary before making a request under section 318(1)(d) of the Companies Act 1993. However, those payments may be made in the ordinary course of business rather than for the purpose of enabling liquidation.

21. Other steps undertaken may not reach the required threshold "to achieve liquidation". For each liquidation procedure, the series of steps involved will largely be settled by the governing legislation, usually the Companies Act 1993. However, in relation to each procedure some preliminary steps will usually occur before any decision to liquidate is made and will end in that decision being made. The decision to liquidate is then followed by a further series of steps that achieve the liquidation and removal of the company from the register of companies.

22. The word "achieve" requires an end or goal to have been established and committed to. In paragraph (b) of the definition of "liquidation", the words "to

achieve liquidation" mean the steps must be taken with liquidation as the established end. Therefore, in the Commissioner's view, until the decision to liquidate is established and committed to, steps cannot be said to have been taken "to achieve liquidation".

23. This emphasis on the established goal of liquidation means some steps that are preparatory to the removal of the company from the register (for example, the exercise by the liquidator of his or her functions) are capable of being the first step to achieve liquidation. However, a decision to liquidate must have been made.

24. While a decision to liquidate has to be made in practice, the step required by law in relation to a company's decision is usually the passing of a resolution. The silent making of a decision is not an overt act, so is not a "step" as required by paragraph (b) of the definition of "liquidation". The passing of a resolution is an overt act—a "step"—and will, in most cases in the Commissioner's view, be the first step legally necessary to achieve liquidation. The passing of such a resolution will also satisfy paragraph (b)(ii) as being for the purpose of enabling liquidation.

What is the first step legally necessary to achieve liquidation on a short-form liquidation?

25. One of the two grounds in section 318(2) of the Companies Act 1993 must be satisfied before a request for removal from the register of companies under section 318(1)(d) can be made. However, only the first ground applies where the company has surplus assets to distribute. Therefore, the first ground is the only ground considered in this Ruling. The first ground requires the company to have ceased business, paid its creditors, and distributed any surplus assets in accordance with its constitution and the Companies Act 1993.

26. Therefore, it follows that in those circumstances the first step that is legally necessary when a request is made to remove the company from the register should relate to ceasing business, paying all creditors, and distributing surplus assets. Section 318(2)(a) of the Companies Act 1993 does not specify the order in which these events must occur.

27. Accordingly, the Commissioner accepts that the first step legally necessary to achieve liquidation when a request is made to remove a company from the register of companies under section 318(1)(d) of the Companies Act 1993 is a resolution to:
    - cease business;
    - pay all creditors;
    - distribute surplus assets; and then
    - request removal from the register of companies.

28. Other steps may be taken that could also be the first step that is legally necessary to achieve liquidation. For example, a company may act less formally than by passing a resolution to carry out the grounds in section 318(2) of the Companies Act 1993. If the step is overt and carried out with the aim of achieving removal from the register, it may still be the first step that is legally necessary to achieve liquidation. However, a company taking a less formal course of action may be required to produce evidence establishing that the taking of the step was carried out with the aim of achieving liquidation.

What is the significance of the examples in paragraph (b)(i) of the definition of "liquidation" in section YA 1?

29. After the phrase "a step that is legally necessary to achieve liquidation", paragraph (b)(i) of the definition of "liquidation" in section YA 1 sets out two examples: "including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993".

30. The examples can be read as being the first steps of the relevant processes that Parliament put in the section as specific illustrations of first steps that start the period. However, in the Commissioner' view, the wording of paragraph (b) is ambiguous. The steps could be examples of:
    - *a* step that is legally necessary to achieve liquidation; or
    - the *first* step that is legally necessary to achieve liquidation.

31. Possibly, the more obvious meaning is that the examples are of first steps—suggested by the immediate context and the emphasis in the section. The focus of paragraph (b)(i) is on determining "the period" and its commencement, which suggests the examples are of first steps rather than any steps of the processes to which they are relevant. However, this is not conclusive. Whether the examples should be taken to be the first steps or just any steps in the processes they are relevant to becomes clearer when the examples are examined.

32. The first example refers to the appointment of a liquidator. In the processes of liquidation, the appointment of a liquidator is not the first step legally necessary to achieve liquidation. For example, where the shareholders of a company resolve to appoint a liquidator, obviously the resolution is a legally necessary step that precedes the appointment.

33. Regarding the second example, when removal from the register is requested under section 318(1)(d) of the Companies Act 1993, the request is also not the first step legally necessary to achieve liquidation. In the Commissioner's view passing a resolution to cease business, pay all creditors, distribute surplus assets, and to then request removal will usually be the first step that is legally necessary to achieve liquidation.

34. Therefore, in the Commissioner's view, the better interpretation of paragraph (b)(i) is that the steps given as examples are not the first steps legally necessary to achieve liquidation in the liquidation processes they relate to. Instead, they are examples of steps (in fact, fundamental steps) in those processes. The Commissioner considers that a step other than one of the two examples included in paragraph (b)(i) could be the first step that is legally necessary to achieve liquidation. And, as noted above, the Commissioner considers that step will usually be the passing of a resolution to cease business, pay all creditors, distribute surplus assets, and then request removal.

What is the tax treatment of capital distributions made on a short-form liquidation?

35. The importance of determining the first step legally necessary to achieve liquidation is highlighted when determining the tax treatment of capital distributions made on a short-form liquidation. Capital distributions may not be dividends for tax purposes when they are made "on the liquidation" of a company under section CD 26.

36. Under section CD 3, the term "dividends" includes a wide variety of payments, distributions, and transactions that essentially transfer value to shareholders. Section CD 26(1) and (2) exclude from being a dividend any amounts distributed to shareholders that are essentially subscribed capital ("available subscribed capital per share") and capital gains ("available capital distribution amount") where the amounts are distributed "on the liquidation of the company".

37. Paragraph (b) of the definition of "liquidation" in section YA 1 provides that the period known as "on liquidation" starts with the first step that is legally necessary to achieve liquidation. As discussed above, the Commissioner's view is that the first step is not the making of the request. The first step will ordinarily be the passing of the resolution to cease business, pay all creditors, distribute surplus assets, and then request removal.

38. Therefore, any capital distributions made after the passing of such a resolution will be made "on the liquidation of the company" and may be excluded from being dividends under section CD 26.

39. In some cases there may be an extended period between the first step legally necessary to achieve liquidation and the removal of the company from the register. The period may even span different tax years, so that a distribution is made in a period preceding the removal of the company from the register. The Commissioner will assume that such distributions are made pursuant to a genuine intention to liquidate. However, if the liquidation is not completed then such a distribution will not have occurred "on liquidation", and the exclusion under section CD 26 (and this Ruling) will not apply.

40. Taxpayers making distributions should ensure they keep adequate records of relevant resolutions or other decision-making acts. This is so they can demonstrate that the essential genuineness of the resolution or other act preceded the distribution of the company's assets, and that the distributions were for the purpose of enabling liquidation.

PUBLIC RULINGS BR PUB 10/07: COMMISSIONS RECEIVED BY LIFE AGENTS ON THEIR OWN POLICIES AND THOSE OF ASSOCIATED PERSONS – INCOME TAX TREATMENT; AND BR PUB 10/08: DISCOUNTED PREMIUMS ON LIFE INSURANCE POLICIES PROVIDED TO LIFE AGENTS AND ASSOCIATED PERSONS – FRINGE BENEFIT TAX IMPLICATIONS

Note (not part of rulings): The issues dealt with by these Rulings were first covered in Public Ruling BR Pub 96/9A, published in *Tax Information Bulletin* Vol 8, No 8 (November 1996). The arrangements became the subject of two separate rulings. The taxation of commissions issue was covered in BR Pub 00/01 and the fringe benefit issue in BR Pub 00/02. BR Pub 00/01 and BR Pub 00/02, published in *Tax Information Bulletin* Vol 12, No 4 (April 2000), expired on 31 December 2004.

PUBLIC RULING BR PUB 10/07: COMMISSIONS RECEIVED BY LIFE AGENTS ON THEIR OWN POLICIES AND THOSE OF ASSOCIATED PERSONS – INCOME IMPLICATIONS

This is a Public Ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of sections CB 1 and CE 1.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a life insurance policy by a life insurer to a life agent or persons associated with the life agent. The life agent either:

- receives commissions on those policies; or
- sets off commissions on those policies against premiums payable on the life agent's own life policy or those of associated persons.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Commissions received by a life agent on the life agent's own life policy or policies of persons associated with the life agent are income under section CB 1 (if the life agent is an independent contractor) and section CE 1 (if the life agent is an employee).
- When a life agent sets off commissions against premiums payable on these policies, the amount of commission set off is income under section CB 1 or CE 1.

The period for which this Ruling applies

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

This Ruling is signed by me on the 29th day of April 2010.

Susan Price
Director, Public Rulings

PUBLIC RULING BR PUB 10/08: DISCOUNTED PREMIUMS ON LIFE INSURANCE POLICIES PROVIDED TO LIFE AGENTS AND ASSOCIATED PERSONS – FRINGE BENEFIT TAX IMPLICATIONS

This is a Public Ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

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

This Ruling applies in respect of section CX 2.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a life insurance policy by a life insurer to a life agent or persons associated with the life agent in return for discounted premiums.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- When a life agent or persons associated with the life agent receive discounted premiums on a life insurance policy from the life agent's employer, the policy will be a fringe benefit under section CX 2 if it is provided in connection with the life agent's employment. The life insurer will be liable for fringe benefit tax (FBT) on the taxable value of the benefit.

The period for which this Ruling applies

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

This Ruling is signed by me on the 29th day of April 2010.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 10/07 AND BR PUB 10/08

This commentary is not a legally binding statement, but provides assistance in understanding and applying the conclusions reached in Public Rulings BR Pub 10/07 and BR Pub 10/08.

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

Summary

These Rulings and commentary are about situations where life agents sell life insurance policies to themselves or persons associated with them. The issues that the Rulings and commentary are particularly concerned with are as follows:

- Which arrangements are subject to income tax and which are subject to fringe benefit tax;
- Whether commissions received by agents on their own life insurance policies are amounts received from trading with themselves and so are not income;
- Whether income is received when the agent does not directly receive commissions and they are instead set off against premiums they are obliged to pay on their own life insurance policies;
- Whether a life insurer will be liable for FBT when it provides a life insurance policy to a life agent at a discount.

The Rulings conclude:

- Commissions received by life agents on their own policies, or policies of persons associated with the life agent, are income.
- When a life agent sets off a commission against premiums due on a life insurance policy purchased from their employer, the amount of commission is income.
- Life agents, who agree that no commission entitlement will arise on their own policies or policies of associated persons, are not assessable on any notional commission; that is, the amount of commission that would have been received. When a life agent agrees that no commission entitlement will arise, no income comes in.
- A life insurer will be liable for FBT when the life insurer provides a life insurance policy at a discount to a life agent or persons associated with the life agent and that policy is provided in connection with the life agent's employment. The life insurer will be liable for FBT on the taxable value of the benefit.

Background

The subject matter covered in these Rulings was previously dealt with by BR Pub 96/9A published in *Tax Information Bulletin* Vol 8, No 8 (November 1996), page 6. Public Ruling BR Pub 96/9A dealt with the income tax and fringe benefit consequences when life agents take out life policies on their own lives and those of their families. That Ruling expired on 31 December 1999. The arrangements covered by BR Pub 96/9A became the subject of two separate rulings. The taxation of commissions issue was covered in BR Pub 00/01 and the fringe benefit issue in BR Pub 00/02. A single commentary accompanied both Rulings. BR Pub 00/01 and BR Pub 00/02 expired on 31 December 2004.

The Commissioner is satisfied that the conclusions in BR Pub 00/01 are correct. BR Pub 00/02 and the commentary to the Rulings required minor adjustments to reflect the Commissioner's view that for the purposes of FBT, "benefit" refers to the provision of a life insurance policy in connection with the employment relationship (and not the amount of the discounted premiums). Both Rulings have also been updated for the 2007 Act.

Legislation

Section CB 1 states:

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

Section CE 1 states:

> **Amounts derived in connection with employment**
>
> The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> (b) expenditure on account of an employee that is expenditure on account of the person:
>
> (c) the market value of board that the person receives in connection with their employment or service:
>
> (d) a benefit received under a share purchase agreement:
>
> (e) directors' fees:
>
> (f) compensation for loss of employment or service:
>
> (g) any other benefit in money.

Section CX 2 defines "fringe benefit" as:

Meaning of fringe benefit

Meaning

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

Section GB 32 states:

Benefits provided to employee's associates

When this section applies

(1) This section applies when—

(a) a benefit is provided to a person who is associated with an employee of an employer; and

(b) the benefit would be a fringe benefit if provided to the employee; and

(c) the benefit is provided either by the employer or by another person under an arrangement with the employer for providing the benefit; and

(d) the exemption in subsection (2) does not apply.

Exemption for shareholder-employees and corporate associates

(2) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is a company; and

(b) the employee is a shareholder in the company; and

(c) the person associated with the employee is a company; and

(d) the benefit is not provided under an arrangement that has a purpose of providing the benefit either—

(i) in place of employment income; or

(ii) free from fringe benefit tax.

Benefit treated as provided to employee

(3) For the purposes of the FBT rules, the benefit is treated as provided by the employer to the employee.

Application of section CX 18

(4) Section CX 18 (Benefits provided to associates of both employees and shareholders) applies to determine when a benefit provided to an associate of both an employee and a shareholder is treated as a fringe benefit and not a dividend.

The terms "employee", "employer" and "employment" are defined for FBT purposes by reference to the PAYE system. The term "PAYE income payments" is defined in section RD 3 as:

Meaning generally

(1) The PAYE rules apply to a PAYE income payment which—

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2)

(iii) an amount paid or benefit provided, by a person (the claimant) who receives a personal service rehabilitation payment from which an amount of tax has been withheld at the rate specified in schedule 4, part I (Rates of tax for schedular payments) or under section RD 18 (Schedular payments without notification), to another person for providing a key aspect of social rehabilitation referred to in paragraph (c) of the definition of personal service rehabilitation payment in section YA 1 (Definitions).

Section RD 27 states:

RD 27 Determining fringe benefit values

What sections RD 28 to RD 53 do

(1) Sections RD 28 to RD 53 set out the rules for determining the value of a fringe benefit provided by an employer to an employee in connection with their employment. The taxable value of a fringe benefit when an employee pays an amount for receiving the benefit is dealt with in sections RD 54 to RD 57.

When value cannot be ascertained

(2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.

Meaning of market value

(3) In subsection (2), market value means the price, at the time at which the goods or services were provided to the employee, for which the goods or services would normally be sold in a sale—

(a) in the open market in New Zealand; and

(b) freely offered; and

(c) made on ordinary trade terms; and

(d) to a member of the public at arm's length.

When services are provided to an employee, and the services are provided as part of the employer's business, the fringe benefit is valued in accordance with section RD 41:

Price, amount paid, or fee

(1) The value of a fringe benefit that an employer provides to an employee in services is,—

(a) when an employer normally provides the services as part of their business, the price charged by the employer—

(i) at the time they provided the services; and

(ii) for the same or similar services to the public in the open market in New Zealand; and

(iii) on ordinary trade or professional terms between buyers and sellers independent of each other:

(b) when an employer pays for the services to be provided, dealing at arm's length with the supplier of the services, the amount paid or payable:

(c) if neither paragraph (a) nor (b) applies, the price or fee that the employer or supplier providing the services would at that time have charged the public, had they provided the same or similar services to the public in the open market in New Zealand on ordinary trade or professional terms.

Exclusions

(2) This section does not apply to a service that consists of making available a motor vehicle for private use, providing an employment-related loan, or providing subsidised transport.

Services provided to group of employees

(3) For the purposes of this section, a person who provides services to an employee belonging to a group of employees is treated as providing the same or similar services to the public in the open market in New Zealand on ordinary trade or professional terms if the person provides the same or similar services to a group of persons that—

(a) negotiates the transaction on an arm's-length basis; and

(b) is comparable in number to the group of employees.

Some definitions

(4) In this section,—

amount, for a registered person who may claim input tax for that service, means the GST-inclusive amount

fee and **price**, for a registered person who may claim input tax for that service, means the GST-inclusive fee or price.

Section RD 54(1) provides:

Value of benefit

(1) The taxable value of a fringe benefit is the value of the benefit. Subsection (2) overrides this subsection.

Reduction for payment by employee

(2) If an employee pays an amount for receiving a fringe benefit, the value of the benefit is reduced by the amount paid.

When associate pays amount

(3) If section GB 32 (Benefits provided to employee's associates) applies, the value of the benefit is reduced when a person associated with the employee pays an amount for the benefit.

Exclusions

(4) This section does not apply to—

(a) an employment-related loan:

(b) a payment to acquire or improve an asset if receiving or using the asset does not constitute a fringe benefit.

Section YA 1 defines "employer" and "employee" for the purposes of the FBT rules.

"Employee":

(a) means a person who receives or is entitled to receive a PAYE income payment:

(b) in sections CW 17 (Expenditure on account, and reimbursement, of employees) and CW 18 (Allowance for additional transport costs) includes a person to whom section RD 3(2) to (4) (PAYE income payments) applies:

(c) in the FBT rules, and in the definition of **shareholder employee** (paragraph (b)), does not include a person if the only PAYE income payment received or receivable is—

(i) a payment referred to in section RD 5(1)(b)(iii), (2), (6)(b) and (c) and (7) (Salary or wages):

(ii) a schedular payment referred to in schedule 4, parts A and I (Rates of tax for schedular payments) for which the person is liable for income tax under section BB 1 (Imposition of income tax):

(d) is defined in section DC 15 (Some definitions) for the purposes of sections DC 12 to DC 14 (which relate to share purchase schemes):

(e) for an employer, means an employee of the employer.

"Employer":

(a) means a person who pays or is liable to pay a PAYE income payment:

(b) includes,—

(i) for an unincorporated body of persons other than a partnership, the manager or other principal officer:

(ii) for a partnership, each partner:

(iii) for the estate of a deceased person, a trust, a company in liquidation, an assigned estate, or for any other property vested or controlled in a fiduciary capacity, each person in whom the property has become vested or to whom control of the property has passed:

(iv) the Crown:

(c) in the FBT rules, does not include a person if the only PAYE income payment that they pay or are liable to pay is—

(i) a payment referred to in section RD 5(1)(b)(iii), (3), (6)(b) and (c), and (7) (Salary or wages):

(ii) a schedular payment referred to in schedule 4, parts A and I (Rates of tax for schedular payments):

(d) is defined in section RD 45(6) (Unclassified benefits) for the purposes of that section:

(e) for an employee, means the employer of the employee.

Application of the legislation

1. Commissions received by life agents on their own policies or policies of associated persons

Insurance agents may receive commissions when they sell life insurance policies. Usually an insurance agent's entitlement to commissions is set out under a life agent's terms of engagement or employment contract.

"Income" is not a term of art and has to be examined in accordance with ordinary concepts and usages (*Scott v C of T* (1935) 35 SRNSW 215 at page 219). The courts have identified several criteria that are considered to be the hallmarks of receipts of an income nature. The High Court in *Reid v CIR* (1983) 6 NZTC 61,624 at page 61,629 described the criteria as follows:

- income is something which comes in; and
- income imports the notion of periodicity, re-occurrence and regularity; and
- whether a particular receipt is income depends upon its quality in the hands of the recipient.

An important feature of income is that it is something that comes in. This was emphasised in *Lambe v IR Commrs* (1933) 18 TC 212 where Finlay J said at page 217:

> Of course income may be of various sorts, … but none the less the [income] tax is a tax on income. It is a tax on what in one form or another goes into a man's pocket. That is the general principle.

Commissions received by life agents on their own policies or the policies of associated persons come in, in the same way that commissions from the sale of policies to unrelated third parties come in.

The major determinant in many cases is the periodic nature of the payment. Generally, commission income is periodic in nature. However, this in itself is not enough. It is necessary to consider the relationship between the life insurer and the life agent to determine the quality of the commission in the hands of the life agent.

Alternative arguments

One possible argument is that commissions received by life agents on their own policies are not income but are the proceeds from mutual transactions.

Mutual transactions

The general principle of income tax known as "mutuality" starts from the premise that a person cannot make a profit from trading with himself or herself, or with a body or association of persons of which the person is a member. In *Sydney Water Board Employees' Credit Union Ltd v FC of T* (1973) ATC 4,129 Barwick J said (at page 4,131):

> The description "mutuality principle" is used, unfortunately as I think, to express the reason for the conclusion that the return to a taxpayer of a share of the surplus of a fund to which he has contributed in common with others after its use for a purpose agreed between them is not income … **What distinguishes the amount refunded in such circumstances from profit or income is that the payment is made out of moneys which are in substance the moneys of the contributors.**
>
> [Emphasis added]

Prima facie the profits from mutual transactions are not income.

There are numerous cases discussing the mutuality principle. Most discuss the situation where a person trades with a body or association of persons of which he or she is a member. There was some discussion of the principle that a person cannot trade with himself or herself in *Dublin Corporation v M'Adam* (1883-1890) 2 TC 387 at page 397. The court stated that:

> There must be, at least, two parties … If these two parties are identical, in my opinion there can be no trading. No man, in my opinion, can trade with himself; he cannot, in my opinion, make, in what is its true sense or meaning, taxable profit by dealing with himself; and in every case of this description it appears to be a question on the construction of the Act whether the two bodies – the body that supplies and the body or class that has to pay – were either identical, or, upon the true construction of the Act, must be admitted to have been held by the Legislature to be identical …

Does the mutuality principle apply?

Although the life agent is the person who causes the commission to be paid by taking up the policy on that person's life or the lives of the person's family, the commission is not a return of the life agent's own money. The commission comes from a source outside of the life agent, that is, from the funds of the life insurer. The life agent is paid the commission for introducing business to the life insurer, not for taking out the policy and paying the premiums.

Case law indicates that the mutuality principle only applies when a person trades with himself or herself, that is, there is only one party to the transaction giving rise to the income. Here there are two parties to the transaction. The commission arises from the sale of a life insurance product by one party (the life insurer) to another party (the life agent). It does not matter that the life insurance product is sold by the life insurer through the life agent. There are still two parties to the transaction.

Mutuality principle – conclusion

The mutuality principle does not apply to commissions received by life agents on their own policies.

Discount on premiums

It may also be argued that commissions received by life agents on their own policies should be regarded as discounts from the premiums payable under the policy and not as income. For example, a life agent takes out a policy on his or her life. The premium is $1,000. The life agent receives a commission of $200. The $200 can be seen as a discount, that is, the "real" cost of the policy is $800.

This was the view taken in "Commissions on Life Insurance Sold to Agent's Family" in *Tax Information Bulletin* Vol 4, No 10 (May 1993), which states:

> Commissions received by agents or employees of Life Insurance Offices who take out life insurance policies on their own lives or on the lives of their immediate family members should be regarded as reductions or discounts from the premiums payable under the policies, and not as assessable income.

The Commissioner now considers that the treatment of commissions as reductions or discounts from the premiums payable under the policies is incorrect. This is because commissions received by life agents on their own policies or the policies of associated persons "come in" and are therefore income. The fact that a commission is set off against a life agent's obligation to pay premiums does not affect the derivation of the commission. Commissions received by life agents on their own policies are treated in the same way as commissions received from the sale of policies to unrelated third parties.

The commission payment arises from an arrangement between the life agent and the life insurer. The life agent receives the commission for introducing business to the life insurer, not for taking out the policy and paying the premiums.

Conclusion

Commissions received by life agents on their own policies or those of associated persons are income under section CB 1 or CE 1.

2. *Life agents' commissions are set off*

Life agents may set off commissions received on their own policies or those of associated persons against the premiums payable on their own policies.

Under section BD 3(4), an amount is deemed to have been derived by a person although it has not actually been paid to, or received by, the person, or already become due or receivable:

> Despite subsection (3), income that has not previously been derived by a person is treated as being derived when it is credited in their account or, in some other way, dealt with in their interest or on their behalf.

Case law has established that income is derived under section BD 3(4) when the taxpayer does not receive a payment of that income, but receives some other monetary benefit. This has been found to occur when income that would otherwise have been paid to the taxpayer is diverted for uses that are of benefit to the taxpayer (*Dunn v C of IR* (1974) 1 NZTC 61,245).

When life agents set off the commission, the amount of commission is income under section CB 1 or CE 1. The commission (which would otherwise have been paid to the agent) is diverted for uses that produce other financial benefits to the life agent, that is, payment of the premiums on their own policies.

The practice of setting off commissions on policies may also occur in respect of policies sold to third parties. For example, a life agent sells a policy to an unrelated third party and becomes entitled to a commission. Instead of being paid the commission, the life agent sets the commission off against premiums payable on their own policies. Here, the commission, although not paid to the life agent, is derived by the life agent and is therefore income.

3. *Charging of discounted life insurance premiums to life agents or associated persons*

It is common for life insurers to allow life agents to receive lower commissions in order to discount premiums to prospective clients. The Commissioner understands that if a life agent agrees that no commission entitlement will arise on the sale of a policy, there is a corresponding reduction in the premiums payable under that policy.

The Commissioner also understands that when life agents agree that no commission entitlement will arise on their own policies or those of associated persons, the premiums payable under those policies are reduced.

Life agents who agree that no commission entitlement will arise on policies sold to third parties are not assessable on any notional commission; that is, the amount of commission that would have been received. As discussed, an important feature of income is that it is something that comes in. When a life agent agrees that no commission entitlement will arise, no income comes in.

This must also be the case when life agents agree that no commission entitlement arises on their own policies or those of associated persons. Because the life agent receives no commission, no income arises.

Alternative arguments

An important feature of income is that it is something that comes in. When life agents agree that no commission entitlement will arise on their own policies no money comes in. They do not receive a commission. However, the issue of convertibility arises if a life agent either takes the commission, or agrees that no entitlement will arise and receives a discounted premium on a policy on the agent's own life or that of an associated person. In particular, does the fact that the life agent can receive the commission in lieu of the discounted premium mean that the discounted premium is convertible into money, and therefore assessable?

Case law

The principle of convertibility was initially laid down in *Tennant v Smith* [1892] 3 TC 158. *Tennant* involved a bank employee who received a benefit in the form of rent-free accommodation. The issue was whether the accommodation was assessable under Schedule E of the United Kingdom legislation (by virtue of the words "salaries, fees, wages, perquisites or profits payable"). The court held that the taxpayer would only be taxable if what he received was convertible into money, that is, was money or money's worth. Because the taxpayer could not sublet the accommodation or turn it to pecuniary account in any other way, he was not taxed.

The principle of convertibility has been discussed and applied by the New Zealand courts on several occasions. See *C of IR v Parson (No. 2)* (1968) NZLR 574, *Stagg v Inland Revenue Commissioner* (1959) NZLR 1,252 and *Dawson v Commissioner of Inland Revenue* (1978) 3 NZTC 61,252.

The convertibility test is normally satisfied by demonstrating that the benefit may be sold or exchanged for money. In Stagg the value of holiday airfares given to an employee was held not to be assessable income of the employee. The employee could not sell the fares or require the company to give him the equivalent cash value.

However, it is clear from the case law that there are other ways in which convertibility can be satisfied. See *Abbott v Philbin* [1961] 2 All ER 763 and *Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70.

The principle of convertibility was considered by the New Zealand Supreme Court in *Dawson*. The taxpayer subscribed for debenture stock under a debenture holders' colour television plan. Under that plan a person could subscribe for debenture stock and would receive in return a television free of hire for five years. No interest was payable on the debentures.

The Commissioner argued that the use of the television set was the substitution of one form of a benefit for another, that is, interest, and in taking the hire of the set rather than the payment of interest, the taxpayer received a benefit that could be valued in terms of money.

McMullin J said at page 61,258:

> In the view which I take of this matter, it is of some importance to note that [the] Objector did not apply for a television set as an alternative to an interest-bearing investment. It is true that it was open to him initially to choose to invest in interest-bearing stock as, I have no doubt, many other investors did, but he completed his application for a television set and a television set only.

The court held that the benefit the taxpayer received was that he did not have to pay rental for the television. That benefit did not constitute income in the ordinary sense because the benefit received by the taxpayer was not in monetary form, nor was it capable of being sold, surrendered, assigned, or mortgaged for money or money's worth.

Arguably, *Dawson* provides some support for the view that the receipt of a discounted premium is convertible into money or money's worth, the discounted premium being a substitution for the commission. It may be inferred from the court's comments in *Dawson* that if the taxpayer had the option of investing and receiving either a television set or an interest-bearing investment, and in fact received a television set, the benefit would be convertible into money.

However, it is considered the better view is that discounted premiums are not convertible into money or money's worth.

The fact that a life agent initially has the choice of receiving a commission, or not receiving a commission and enjoying a discounted premium, is not relevant. The issue of convertibility is considered at the time the taxpayer receives the benefit.

If a life agent chooses to receive a commission, no question of convertibility arises because the commission is money.

However, when a life agent chooses to receive a discounted premium, it is the discounted premium itself that must be convertible into money or money's worth. At the time the discounted premium is received it cannot be converted into money because the life agent no longer has the option to receive any commission. Therefore, the convertibility principle does not apply.

Conclusion

When a life agent or persons associated with the life agent receive discounted policies, the amount of the discount is not income of the life agent.

4. FBT and discounted policies

A life insurer who provides discounted premiums to life agents or persons associated with the life agent may be liable for FBT.

For the purposes of FBT a life agent is an "employee", regardless of whether the life agent is an employee or an independent contractor at common law.

Employee versus independent contractor

The terms "employee", "employer" and "employment" are defined for FBT purposes by reference to the PAYE system.

Section YA 1 defines "employee" for the purposes of the FBT rules as meaning:

> … a person who receives or is entitled to receive a PAYE income payment.

There are certain exclusions in the definition of "employee" for the purposes of the FBT rules, but they are not applicable to the arrangements in these Rulings.

Section RD 3 defines "PAYE income payment" as:

> (1) The PAYE rules apply to a PAYE income payment which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
>
> (ii) extra pay, see section RD 7; or
>
> (iii) a schedular payment, see section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
>
> (ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2).

Under section RD 8, all payments of the classes specified in Schedule 4 are schedular payments for the purposes of the PAYE rules. Included in Part G of Schedule 4 are commissions or other remuneration to insurance agents or sub-agents, or to salespeople.

A life agent who is an employee at common law is an "employee" for the purposes of FBT because they receive a type of PAYE income payment, namely salary and wages. A life agent who is an independent contractor at common law is also an "employee" for the purposes of FBT because they receive a type of PAYE income payment, namely schedular payments.

Discounts on family policies

Under the arrangements covered by these Rulings, if an employer provides a benefit to an associated person of any of the employer's employees (for example, a relative) and the benefit would have been a fringe benefit if provided to the employee, section GB 32 deems the benefit to be a benefit provided to the employee.

From 1 April 2010, for the purposes of the arrangement, "associated person" is defined in section YB 1. An "associated person" includes two persons who are relatives as defined in section YB 4.

A relative of a life agent is any person connected with the life agent:

- by blood relationship if within the second degree of relationship (a child by adoption is treated as a natural child); or
- by marriage, civil union or de facto relationship; or
- by blood relationship to the spouse or partner of the life agent (if within the second degree of blood relationship to the spouse or partner).

For periods before 1 April 2010, the degree of blood relationship required to establish that a person is a relative of an employee is four degrees of blood relationship.

Is there a fringe benefit?

As discussed, when a life agent agrees that no commission entitlement will arise and receives a discounted premium, that discounted premium is not income of the life agent.

A discounted premium that represents a reduction in charges other than commission is also not income. A discount is not regarded as income. Income is something that comes in, not something that is saved from going out (see *Tennant* per Lord Halsbury at page 165).

The issue then is whether life insurance policies provided by life insurers to life agents or associated persons, where the premiums are discounted, constitute fringe benefits.

Analysis

Section CX 2 defines "fringe benefit" for the purposes of the FBT rules:

> *Meaning*
>
> (1) A **fringe benefit** is a benefit that—
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6,

CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

It is clear from the opening words of CX 2(1) that in order for there to be a fringe benefit, there must be some benefit to the employee, provided by the employee's employer. A fringe benefit is any benefit provided by the employer to the employee in connection with their employment, unless expressly excluded by subpart CX. That benefit is then valued under section RD 27, and its taxable value is calculated under section RD 54. The value of the benefit and its taxable value are discussed in more detail below.

If a life agent or associated person purchases a life insurance policy from the life agent's employer, there is a benefit provided to the life agent if the policy is provided in connection with the life agent's employment.

A life agent may have a discretion to reduce his or her commission in order to reduce premiums on policies sold to members of the public as well as to themselves or persons associated with them (for example, relatives). A life agent, or associated person, who enjoys a discounted premium on their own life insurance policy or family policies may receive a benefit, if that discount is provided by the life agent's employer in connection with the life agent's employment. However, if the same discount is available to members of the public, then the discount may not be provided in connection with the life agent's employment and will not be a fringe benefit. Whether or not a benefit has been provided in connection with the life agent's employment will depend on the facts of each case.

The benefit in these situations is the receipt of services (the life insurance policy) from the employer by the employee in connection with their employment and is consequently a fringe benefit under section CX 2. This was discussed in a Question We've Been Asked entitled "The Meaning of 'Benefit' for FBT Purposes" in *Tax Information Bulletin*, Vol 18, No 2 (March 2006). The amount of any discount and any consideration provided by the employee will be relevant to determining the taxable value of the benefit.

Section CX 16 applies when an employer pays a specified insurance premium or makes a contribution to the insurance fund of a friendly society for the benefit of an employee. In the Arrangement covered by this Ruling, section CX 16 does not apply because the life insurer does not pay the life insurance premiums of the life agent or persons associated with the agent. Section CX 14 also does not apply to the Arrangement covered by the Ruling. Section CX 14 applies to "sickness, accident, or death benefit funds" as defined in section YA 1.

Value of the benefit

The Act provides methods for valuing a fringe benefit in section RD 27. Section RD 41 determines the value of services provided to an employee when they are provided as part of the employer's business.

In the Arrangement covered by these Rulings, the fringe benefit is the provision of a life insurance policy. The life insurer is in the business of selling such life insurance policies to members of the public. Therefore, section RD 41 applies to determine the value of the fringe benefit.

Section RD 41 provides that the value of a benefit that is normally provided by an employer as part of its business, will be the price charged at the time they provide the same or similar services, on ordinary trade or professional terms between buyers and sellers independent of each other. It is a question of fact whether the price charged to the life agent or associated person for the policy is the same as is customarily charged to a member of the public in the open market on ordinary trade terms between buyers and sellers independent of each other. Therefore, the extent to which the fringe benefit (the life insurance policy) is subject to FBT will depend on the extent to which any discounts provided to a life agent, or persons associated with the life agent, are greater than the discounts available to members of the public.

The taxable value of the fringe benefit is calculated under section RD 54. Section RD 54 provides that the taxable value of a fringe benefit will be the value of the benefit reduced by any amount paid by the employee, or an associated person, for that benefit. There will be no taxable value if the amount paid for the policy is the same as, or exceeds, the price customarily paid by a member of the public in the open market on ordinary trade terms between buyers and sellers independent of each other.

Expenditure on account of an employee

The Ruling covers the situation when an employer (the life insurer) provides a benefit to the employee (the life agent) or person associated with the life agent (for example, a relative) by discounting the premiums payable by the life agent on the insurance policy. It does not seek to address the situation when the life insurer pays the life insurance premium of a life agent.

When a life insurer pays a life agent's insurance premiums, that expenditure will be expenditure on account of an employee if the employee is liable to pay the insurance premiums. Expenditure on account of an employee is employment income under section CE 1 and is assessable income to the employee, subject to the exclusions under section CE 5(3).

When a life insurer pays a life agent's insurance premiums, and the life insurer is liable for those premiums, that expenditure is a fringe benefit (unless expressly excluded from the definition of fringe benefit in section CX 2).

Period of Rulings

These Rulings commence on the first day of the 2008/09 income year. The previous Rulings expired on 31 December 2004. However, the Commissioner is of the view that the same principles and conclusions as set out in these Rulings would apply in respect of the period beginning on 1 January 2005 and ending on 31 March 2008.

NEW LEGISLATION

ORDERS IN COUNCIL

PARENTAL LEAVE AND EMPLOYMENT PROTECTION – CHANGES TO ADVISOR STATUS

Paid parental leave has been available to employees since 2002. It was extended to self-employed parents in legislation that came into force on 1 July 2006.

Amending regulations have been made to allow those with tax advisor status under the Tax Administration Act 1994, to verify the self-employed status, net income and average weekly earnings of an applicant for paid parental leave.

Previously, an application from a self-employed person had to be accompanied by either:

- a statement and declaration by a chartered accountant, set out in the prescribed form; or
- a declaration made by the parent, in accordance with the Oaths and Declarations Act 1957, in the prescribed form.

The limitation to chartered accountants meant that the authorised person had to be a member of the New Zealand Institute of Chartered Accountants (NZICA).

The amending regulations broaden the range of authorised persons to include tax advisors who are members of an organisation with approved advisor group status under the Tax Administration Act 1994.

Currently, the only organisation other than NZICA with this status is the Tax Agents Institute of New Zealand. However, the amendment does allow other organisations who achieve tax advisor status in the future to verify self-employed applications without the need for further amendment to the regulations.

The amending regulations come into force on 1 July 2010.

Further information is available on the Department of Labour website at **www.ers.dol.govt.nz/parentalleave/** or by calling 0800 20 90 20 during business hours.

Parental Leave and Employment Protection Amendment Regulations 2010 (SR 2010/98)

KIWISAVER FIRST HOME SUBSIDY

The KiwiSaver first home deposit subsidy has been made a social assistance suspensory loan in recognition of its social policy objective. This ensures that recipients of this subsidy are not subject to income tax when the obligation to repay the loan is released.

The KiwiSaver first home deposit subsidy was designed to help first home buyers and previous home owners (who are in a similar financial position to first home buyers), who would be able to sustain a commercial mortgage but face difficulties saving for a deposit. KiwiSavers may be eligible for the deposit subsidy after three years of contributing to the scheme. The subsidy is $1,000 for each year of contribution, up to a maximum of $5,000, and is available from 1 July 2010.

The deposit subsidy is provided as a suspensory loan from Housing New Zealand Corporation to the recipient. For the purposes of the deposit subsidy, a recipient must live in the home for at least six months. After this time there is no longer a requirement to repay the loan. Normally, when a debt is forgiven, the amount becomes "income" for the purposes of the Income Tax Act 2007.

The amending regulations come into force on 1 July 2010.

Income Tax (Social Assistance Suspensory Loans) Amendment Order 2010 (SR 2010/99

LEGISLATION AND DETERMINATIONS

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

CPI ADJUSTMENT – CPI 10/01 FOR DETERMINATION DET 09/02: STANDARD-COST HOUSEHOLD SERVICE FOR CHILDCARE PROVIDERS

In accordance with the provisions of Determination DET 09/02, as published in *Tax Information Bulletin* Vol 21, No 4 (June 2009), Inland Revenue advises that for the 2010 income year:

a) the variable standard-cost component has increased from $3.09 to $3.15 per hour per child; and

b) the administration and record-keeping fixed standard-cost component has increased from $301 to $307 per annum, for a full 52 weeks of childcare services provided.

The above amounts have been adjusted in accordance with the annual movement of the All Groups Consumers Price Index for the 12 months to March 2010, which showed an increase of 2.0%. For childcare providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2009 to 31 March 2010.

CPI ADJUSTMENT – CPI 10/02 FOR DETERMINATION DET 05/03: STANDARD-COST HOUSEHOLD SERVICE FOR BOARDING SERVICE PROVIDERS

In accordance with the provisions of Determination DET 05/03, as published in *Tax Information Bulletin* Vol 17, No 10 (December 2005), Inland Revenue advises that the weekly standard-cost component for the 2010 income year is retrospectively adjusted as follows:

a) The weekly standard-cost for one to two boarders will increase from $227 each to $232 each.

b) The weekly standard-cost for third and subsequent number of boarders will increase from $185 each to $189 each.

The above amounts have been adjusted in accordance with the annual movement of the All Groups Consumers Price Index for the 12 months to March 2010, which showed an increase of 2.0%. For boarding service providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2009 to 31 March 2010.

DETERMINATION FDR 2010/1: REVOCATION OF DETERMINATION FDR 2008/13

Reference

This determination is made under section 91AAO of the Tax Administration Act 1994.

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

Discussion (which does not form part of the determination)

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

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

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

An attributing interest in a foreign investment fund to which this determination applies is the subject of an earlier determination, Determination FDR 2008/13 allowing the use of the FDR method for the interest. Section 91AAO(4) authorises the making of a determination that revokes an earlier determination. This determination revokes Determination FDR 2008/13. The application date varies according to when the attributing interests in the non-resident issuer were acquired.

The determination made in FDR 2008/13 relied on the application of a trading criterion that meant that an actively traded debt portfolio, which met certain criteria, was determined to be more akin to equity than debt. Therefore, despite the non-resident issuer having financial arrangements that were 80% or more by value effectively hedged to New Zealand dollars, its actively traded debt portfolio made it appropriate for the FDR method to be used. However, this criterion is no longer considered appropriate because it creates compliance and administrative concerns, and has now been removed. It is therefore appropriate to revoke Determination FDR 2008/13.

Scope of determination

This determination applies to units held by New Zealand-resident investors, including Tower, a portfolio investment entity, in a non-resident issuer.

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

Interpretation

In this determination unless the context otherwise requires:

"Benchmark date" means 8 March 2010;

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

"Compensation" means an amount paid by Tower for fee rebates or administrative errors in relation to units in Tower;

"Compensation units" are units in Tower that are:

- held by a unit holder on or before the benchmark date; or
- held by a unit holder after the benchmark date, if the units are acquired as a result of compensation in relation to other compensation units;

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

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

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

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

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

"The Act" means the Income Tax Act 2007;

"Tower" means Tower Asset Management International Bond Fund;

"Minimum turnover percentage target" means the target percentage agreed with and disclosed for Determination FDR 2008/13 to the Policy Manager, Inland Revenue who made that determination;

"Target tracking error" means the target percentage agreed with and disclosed for Determination FDR 2008/13 to the Policy Manager, Inland Revenue who made that determination.

Determination

Determination FDR 2008/13 is revoked.

Application date

This determination applies as follows:

1. For the 2015/16 and subsequent income years for:
   a) units in the non-resident issuer acquired on or before the earlier of 31 March 2010 or the time that the number of units on issue is 5 percent more than the greatest number of units on issue on the benchmark date; and
   b) units in the non-resident issuer acquired after the benchmark date, if the units are acquired as a result of compensation in relation to compensation units.
2. For the 2010/11 and subsequent income years for all other units in the non-resident issuer.

Dated at Wellington this 29th day of March 2010.

Peter Frawley
Policy Manager

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK DETERMINATION 2010

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2010".

This determination is made in terms of section EC 15 of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2009–2010 income year.

For the purposes of section EC 15 of the Income Tax Act 2007 the national average market values of specified livestock, for the 2009–2010 income year, are as set out in the following table.

National average market values of specified livestock

Type of livestock	Classes of livestock	Average market value per head $
Sheep	Ewe hoggets	88.00
	Ram and wether hoggets	81.00
	Two-tooth ewes	122.00
	Mixed-age ewes (rising three-year and four-year old ewes)	107.00
	Rising five-year and older ewes	88.00
	Mixed-age wethers	65.00
	Breeding rams	237.00
Beef cattle	*Beef breeds and beef crosses:*	
	Rising one-year heifers	448.00
	Rising two-year heifers	680.00
	Mixed-age cows	791.00
	Rising one-year steers and bulls	566.00
	Rising two-year steers and bulls	791.00
	Rising three-year and older steers and bulls	915.00
	Breeding bulls	1799.00
Dairy cattle	*Friesian and related breeds:*	
	Rising one-year heifers	691.00
	Rising two-year heifers	1106.00
	Mixed-age cows	1378.00
	Rising one-year steers and bulls	393.00
	Rising two-year steers and bulls	635.00
	Rising three-year and older steers and bulls	773.00
	Breeding bulls	1101.00
	Jersey and other dairy cattle:	
	Rising one-year heifers	575.00
	Rising two-year heifers	1014.00
	Mixed-age cows	1275.00
	Rising one-year steers and bulls	335.00
	Rising two-year and older steers and bulls	557.00
	Breeding bulls	984.00
Deer	*Red deer:*	
	Rising one-year hinds	201.00
	Rising two-year hinds	350.00
	Mixed-age hinds	410.00
	Rising one-year stags	240.00

Type of livestock	Classes of livestock	Average market value per head $
	Rising two-year and older stags (non-breeding)	385.00
	Breeding stags	1257.00
	Wapiti, elk, and related crossbreeds:	
	Rising one-year hinds	254.00
	Rising two-year hinds	397.00
	Mixed-age hinds	460.00
	Rising one-year stags	306.00
	Rising two-year and older stags (non-breeding)	456.00
	Breeding stags	1322.00
	Other breeds:	
	Rising one-year hinds	134.00
	Rising two-year hinds	214.00
	Mixed-age hinds	256.00
	Rising one-year stags	162.00
	Rising two-year and older stags (non-breeding)	255.00
	Breeding stags	525.00
Goats	*Angora and angora crosses (mohair producing):*	
	Rising one-year does	57.00
	Mixed-age does	73.00
	Rising one-year bucks (non-breeding)/wethers	42.00
	Bucks (non-breeding)/wethers over one year	55.00
	Breeding bucks	240.00
	Other fibre and meat producing goats (Cashmere or Cashgora producing):	
	Rising one-year does	62.00
	Mixed-age does	71.00
	Rising one-year bucks (non-breeding)/wethers	44.00
	Bucks (non-breeding)/wethers over one year	52.00
	Breeding bucks	305.00
	Milking (dairy) goats:	
	Rising one-year does	160.00
	Does over one year	230.00
	Breeding bucks	330.00
	Other dairy goats	50.00
Pigs	Breeding sows less than one year of age	219.00
	Breeding sows over one year of age	295.00
	Breeding boars	310.00
	Weaners less than 10 weeks of age (excluding sucklings)	75.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	142.00
	Growing pigs over 17 weeks of age (baconers)	208.00

This determination is signed by me on the 20th day of May 2010.

Rob Wells
LTS Manager, Technical Standards
Legal and Technical Services

INTERPRETATION STATEMENT

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.

IS 10/02: MEANING OF "BUILDING" IN THE DEPRECIATION PROVISIONS

Note (not part of the Interpretation Statement): This Interpretation Statement sets out the meaning of the term "building" in the context of the depreciation provisions.

Previously some items of depreciable property that are considered to be buildings under this Interpretation Statement may not have been treated as buildings for depreciation purposes. The Minister of Revenue announced on 30 July 2009 a proposal to "grand-parent" the existing treatment of these items, see **http://taxpolicy.ird.govt.nz/news/2009-07-30-govt-mitigate-building-interpretation#statement** At the end of this Interpretation Statement there is a table listing these items with accompanying examples.

Also, as a result of this statement some asset classes in the Commissioner's Table of Depreciation Rates will be reviewed including the asset classes for carparks (building and pads); buildings (portable) and site huts. Any changes to these asset classes will involve the issuing of new depreciation determinations. Any new depreciation determinations for economic rates will be issued in draft form for consultation.

All legislative references are to the Income Tax Act 2007 unless otherwise stated. The legislation referred to in this Interpretation Statement is set out in the Appendix.

This Interpretation Statement applies on and after 30 July 2009.

Summary

1. This Interpretation Statement sets out the Commissioner's view on the meaning of the term "building" for the purposes of the depreciation provisions contained in the Income Tax Act 2007. The term "building" is not defined in the Income Tax Act 2007. Therefore, the purpose of this Interpretation Statement is to provide a definition, which when applied to an item of depreciable property, will determine whether that item is a building. This is important because the depreciation provisions require taxpayers to know whether an item of depreciable property is a building in order to determine the depreciation treatment of that item.
2. For depreciation purposes, buildings are treated differently from other items of depreciable property. If an item of depreciable property is a building:
   - a different depreciation rate may apply;
   - the 20% loading that applies to certain depreciation rates does not apply; and
   - a deduction for a loss on items no longer used, or a deduction for a loss on disposal, cannot be claimed except in limited circumstances.
3. The term "building" can have various meanings depending on the context in which the term is used. For example, a possible wide meaning of the term "building" includes structures that are "built", such as fences. A possible narrower meaning might exclude certain types of buildings for particular reasons, such as buildings that provide a specialised setting or have a specialised function or purpose or are integrated with plant. The Commissioner's view is that in the context of the tax depreciation provisions, a building is an item within the ordinary or conventional meaning of the term "building". Case law indicates that a building within the ordinary or conventional meaning of that term generally has the following characteristics:
   - A building is a structure of considerable size.
   - A building is permanent in the sense that it is intended to last a considerable time.
   - A building is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands.
   - A building is enclosed by walls and a roof.
   - A building can function independently of any other structure. However, a building is not necessarily a physically separate structure.

4. Given that the design of, and materials used in, buildings are likely to change over time (without altering the basic concept of an ordinary or conventional building), it is not possible to be definitive as to the design or type of materials that are characteristic of such a building. However, the design of a building and the materials used to construct a building need to be of a kind that are intended to last for a considerable period.
5. The appearance and function of the structure are relevant in determining whether a structure is a building for depreciation purposes (that is, whether the structure looks like the conventional idea of a building and is designed for the uses to which conventional buildings are ordinarily put). It is appropriate to ask whether a reasonable person would regard the structure as a building.
6. The Commissioner's view is that the term "building" for the purposes of the depreciation provisions is the ordinary or conventional meaning without modification to exclude certain types of buildings. This interpretation is supported by the definition provided for "temporary building" in section YA 1 and the provision that allows a loss on the destruction of a temporary building (section DB 20). This interpretation is also supported by the legislative development of the depreciation provisions in relation to buildings.
7. At the end of this Interpretation Statement there is analysis on how the Commissioner considers the building characteristics apply to particular items of depreciable property listed in the Commissioner's Table of Depreciation Rates. While the analysis does not cover all items within the Buildings and Structures asset category, it is intended to demonstrate the practical application of the building characteristics identified in this statement. Particular reference is made to items that, as a result of the view set out in this Interpretation Statement, the Commissioner will now treat as buildings for depreciation purposes.

Background

8. To ascertain the meaning of "building" in the depreciation provisions, it is useful first to understand how the term is used in the depreciation provisions. The term "building" has been in the current depreciation regime since the introduction of the regime in 1993. However, the term was also used in the asset disposal provisions prior to the current regime. To understand the current context in which the term "building" is used, it is useful to consider earlier provisions.

Pre-1993 treatment for buildings – depreciation and disposal

9. Prior to the current depreciation regime that was introduced by the Income Tax Amendment Act 1993, buildings were in certain circumstances treated differently from other depreciable assets in the Income Tax Act 1976.
10. The rules dealing with the disposal of depreciated assets required consideration of whether an item of property was a building for various provisions. For example, the provision that specifically excluded depreciable buildings from allowable deductions on loss on disposal, was introduced by the Income Tax Amendment Act (No 4) 1988 as section 117(1A) of the Income Tax Act 1976. In addition to this, the depreciation deduction provision required consideration as to whether an item of property was plant, machinery, or equipment, a temporary building, or premises. Of these terms only the term "temporary building" was defined in the Income Tax Act 1976.
11. Temporary buildings were defined to cover certain types of buildings including buildings that were built to house plant or machinery and needed to be demolished to remove that plant or machinery. Temporary buildings were expressly treated differently from other buildings in various provisions.
12. Section 108(1) of the Income Tax Act 1976 was the depreciation allowance provision. At the Commissioner's discretion, section 108(1) provided for the depreciation of plant, machinery, or equipment, or a temporary building if the depreciation was caused by fair wear and tear or by the item becoming obsolete or useless. Also, at the Commissioner's discretion section 108(1) provided for the depreciation of assets "not being plant, machinery or equipment, or a temporary building" (ie premises) if the depreciation was caused only by fair wear and tear. In this way, section 108(1) required taxpayers to determine whether their assets (including buildings) were plant or premises. Also, section 106(1)(l) of the Income Tax Act 1976 provided that no deduction was allowed for any loss incurred on the demolition, destruction, or disposal of any premises other than a temporary building.
13. Under section 108(1), typically buildings were given cost price (ie straight line) depreciation rates by the Commissioner. The Commissioner published these depreciation rates in the IR 260 booklet.
14. The interim depreciation regime that was introduced by the Income Tax Amendment Act (No 2) 1992 provided for a 25% loading on existing depreciation rates for certain assets acquired after 16 December 1991 and on or before 31 March 1994. The loading

specifically did not apply to buildings. This provision was originally introduced as section 108A of the Income Tax Act 1976. The interim provision was introduced as a short-term measure before the implementation of the changes that led to the current depreciation regime.

15. Therefore, the earlier provisions prior to the current depreciation regime required consideration of a number of terms: "building", "premises", "temporary building", and "plant, machinery or equipment". These terms had been referred to in the Income Tax Act 1976 since it was enacted and were also referred to in the relevant equivalent sections of the Land and Income Tax Act 1954. In this way the earlier provisions operated within a different scheme to the current regime.

Current depreciation regime

16. Unlike the previous depreciation rules, the current depreciation provisions specifically require consideration as to whether an item of depreciable property is a building rather than whether it is premises, plant, machinery or equipment, or a temporary building. (However, it is still necessary to consider whether a building is a temporary building for particular provisions outside the depreciation provisions.)

17. A deduction is allowed for the depreciation loss on an item owned by a person that is "depreciable property" and that is used or available for use by the person to the extent that the loss was incurred in deriving assessable income: sections DA 1 and EE 1(2). "Depreciable property" is property that might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for that purpose: section EE 6(1). Section EE 7(a) provides that although land cannot be "depreciable property", buildings, fixtures, and the land improvements listed in schedule 13 can be if they satisfy section EE 6(1).

Method of depreciation

18. Generally, three alternative methods are permitted for calculating the amount of a depreciation loss: the straight-line method, the diminishing value method and the pool method: sections EE 9(1) and EE 12 to EE 24. As buildings are not "poolable property", the pool method cannot be used for buildings: sections EE 12(2) and EE 66(2). An item's economic useful life ("EUL") is a component of both the straight-line method and the diminishing value method. An item's EUL is the period over which the item might reasonably be expected to be useful in deriving assessable income or useful in a business for the purpose of deriving assessable income taking into account passage of time, likely wear and tear, exhaustion and obsolescence and assuming the item is subject to normal and reasonable maintenance: section EE 63.

Setting rates

19. Section EE 9(2) directs that the economic rate is dealt with in section EE 26, the annual rate is dealt with in sections EE 31, EE 33, and EE 34, and special and provisional rates are dealt with in sections EE 35 and EE 36.

20. Section EE 26 sets out the relevant provisions for determining economic rates and sets out the ordering of how the various provisions apply. As will be shown, determining whether an item is a building or not is critical to working out what rate-setting provision applies.

21. Section EE 26(1)(a) provides that rates are set under section EE 27 for items that are **not buildings**, fixed life intangible property, excluded depreciable property, or property for which an economic rate is set under section EE 29 or EE 30, and are acquired on or after 1 April 2005. (Section EE 29 is applicable only for certain aircraft and motor vehicles.) Therefore, section EE 26(1)(a) directs that if the item is a building then section EE 27 is not applicable.

22. Section EE 26(1)(b) provides that rates are set under section EE 28 for items that are **buildings acquired on or after 19 May 2005 and do not have a rate set under section EZ 23**. (As well as setting rates for buildings acquired before 19 May 2005, section EZ 23 also sets rates for buildings acquired on or after 19 May 2005 as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic rate set under section EZ 23 or a corresponding section.) Therefore, if the item is a building acquired on or after 19 May 2005 then section EE 26(1)(b) directs that section EE 28 is the rate setting provision for that item (unless it is relationship property described above).

23. Section EE 26(1)(c) provides that rates are set under section EE 29 for certain aircraft and motor vehicles.

24. Section EE 26(1)(d) provides that rates are set under section EE 30 for items that have an estimated residual market value greater than 13.5% of cost (ie, a "high residual value") and would otherwise have a rate set under section EE 27 or EE 28. Therefore, section EE 26(1)(d) directs that rates are generally set under section EE 30 for items with high residual value that are **not buildings acquired on or after 1 April 2005, and buildings with high residual value acquired on or after 19 May 2005**.

25. Section EE 26(1)(e) provides that rates are set under section EZ 23 for items that are **not buildings (or fixed life intangible property, or excluded depreciable property) acquired before 1 April 2005, and buildings acquired before 19 May 2005**.
26. Therefore, in deciding what is the relevant provision for determining a rate for a particular item, section EE 26 requires determination of whether the item is a building. If it was acquired on or after 19 May 2005 then the relevant provision is generally section EE 28 if it is a building that does not have an estimated residual market value greater than 13.5% of cost, or section EE 30 if it is a high residual value building. If the building was acquired before 19 May 2005 then the relevant provision is section EZ 23. Section EZ 23 does not apply to buildings that are excluded depreciable property (ie, buildings that were depreciable property before 1 April 1993 and are being depreciated using the pre-1993 rates).
27. The following table summarises what items the above provisions apply to:

Provision	Items that the provision applies to:
section EE 27	Applies to items that are acquired on or after 1 April 2005 and are **not**: • buildings, • fixed life intangible property, • excluded depreciable property,* • items that have an estimated residual market value greater than 13.5% of cost, or • certain aircraft and motor vehicles.
section EE 28	Applies to buildings acquired on or after 19 May 2005.
section EE 29	Applies to certain aircraft and motor vehicles.
section EZ 23	Applies to: • plant and equipment acquired before 1 April 2005; and • buildings acquired before 19 May 2005 or buildings acquired on or after 19 May 2005 as relationship property or by a company in the same group that are not excluded depreciable property.
section EE 30	Applies to: • plant and equipment acquired on or after 1 April 2005 that have an estimated residual market value greater than 13.5% of cost; and • buildings acquired on or after 19 May 2005 that have an estimated residual market value greater than 13.5% of cost.

* Excluded depreciable property is defined in section EE 64 as depreciable property that was being used before 1 April 1993 and is depreciated using the pre-1993 rates.

28. In addition to the above provisions, section EE 31 provides a 20% loading to be applied to depreciation rates on New Zealand new items acquired in the person's 1995/96 or later income year, excluding buildings, used imported cars, and international aircraft. This is similar to the 25% loading that applied to certain assets during the interim depreciation regime mentioned above.

Loss on disposal and loss on items no longer used

29. A loss on items no longer used and a loss on disposal cannot be claimed in respect of buildings except in certain limited circumstances: sections EE 39 and EE 48(3).
30. However, section DB 20 allows a deduction for a loss incurred through the destruction of a temporary building. A "temporary building" is defined in section YA 1 as a building that:
    - is erected under a permit issued by a local authority or a public authority, and must be demolished or removed if the local authority or the public authority requires its demolition or removal; or
    - is erected at a construction site, and is to be demolished or removed on or before the completion of the construction; or
    - was erected, and is used, to house specific plant or machinery, and will have to be demolished to remove or replace the plant or machinery.

Summary of current depreciation regime – treatment of buildings

31. Therefore under the current regime, it is necessary to determine whether the item of depreciable property is a building for the following reasons:
    - a different depreciation rate, as provided for in section EE 26, may apply; and
    - the 20% loading that applies to depreciation rates provided for in section EE 31 does not apply; and
    - a deduction for a loss on items no longer used, or a deduction for a loss on disposal cannot be claimed except in limited circumstances under sections EE 39 and EE 48(3).

Analysis

32. Although the depreciation provisions require consideration as to whether an item of depreciable property is a building, there is no definition of the term "building" in the Income Tax Act 2007.
33. Section 5 of the Interpretation Act 1999 states:

    (1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.

(3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

34. In *Commerce Commissioner v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767, the Supreme Court most recently set out the approach to be applied in order to interpret legislation applying the requirements of section 5 of the Interpretation Act 1999.

35. The Supreme Court in *Fonterra* held (at para 22) that:

> It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5. In determining purpose the court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.

36. The Supreme Court's approach is consistent with the earlier Court of Appeal decision in *CIR v Alcan New Zealand Ltd* [1994] 3 NZLR 439. In this decision McKay J stated (at page 444), in the context of interpreting tax legislation, that the object of statutory interpretation is to "ascertain the true meaning". This "true meaning":

> … must be consonant with the words used, having regard to their context in the Act as a whole, and to the purpose of the legislation to the extent that this is discernible.

The approach adopted by the court in *Fonterra* was to consider the text first before examining the relevant purpose.

37. As noted, the term "building" is not defined in the Income Tax Act 2007. In approaching the meaning of the text, the ordinary meaning of the term can be considered before going on to consider the meaning of the term as it is used in the context of the depreciation provisions.

Meaning of "building"

38. The *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) defines "building" as:

> 1 a structure with a roof and walls.
>
> 2 the process or trade of building houses and other structures.

39. The *Shorter Oxford Dictionary* (6th ed, Oxford University Press, 2007) defines "building" as:

> 1 A thing which is built, a structure, an edifice, a permanent, fixed thing built for occupation, as a house, school, factory, stable, church, etc.
>
> 2 The action of BUILD verb

40. These definitions indicate that a building is a permanent fixed structure providing shelter, such as a house, school, factory, or stable. This interpretation of "building" has been referred to in case law as the conventional meaning of "building": *R v Marks ex Australian Building Construction Employees' and Builders Labourers' Federation* (1981) 147 CLR 471. However, the dictionary definitions also support a wider interpretation of "building"; that is, a building could simply be a permanent fixed structure or thing that is built.

Conventional meaning of "building"

41. Several factors have been regarded as being characteristic of a building within the conventional meaning of the term.

42. *Stevens v Gourley* (1859) 7 CBNS 99 indicates that a building within the conventional meaning is a structure of considerable size that is permanent (in the sense of durability). Byles J (at p 112) summarised that the term "building" "is usually understood [to be] a structure of considerable size, and intended to be permanent, or at least to endure for a considerable time". Because of changes over time in the types of materials that are used to construct buildings, it is not possible to be definitive about the design or the type of materials that are characteristic of a building; a building will be constructed using the building materials of the day: *Clarke v Wilkie* (1977) 17 SASR 134. However, given the requirement of permanence, a building would usually be constructed of durable materials intended to last for a significant period.

43. A building is also permanent in the sense that it is generally designed to be located permanently on the site where it stands. However, *Stevens v Gourley* indicates that a structure need not be attached to the ground on which it stands in order to be a building. In *Stevens v Gourley* a shop that was fixed to the ground by its own weight and was not easily removed to another site was considered to be a building. A structure that can easily be moved from place to place will not be a building within the conventional meaning. In *Melfort Danceland v Star City (Rural Municipality)* [1977] 3 WWR 737 the court noted that courts had consistently held that a moveable home is not a building.

44. A building in the conventional sense is enclosed by walls and a roof that is designed to provide shelter: *Moir v Williams* [1892] 1 QB 264; *Hilderbrandt v Stephen* [1964] NSWR 740; *Australian Building Construction Employees' & Builders Labourers' Federation v Dillingham Australia Ltd* (1982) 58 FLR 170. In *Moir v Williams* Lord Esher MR commented (at p 270) "what is ordinarily called a building … is an enclosure of brick or stonework covered in by a roof". In *Hilderbrandt v Stephen* Jacobs J discussed the meaning of "building" and stated (at p 742) with reference to *Moir v Williams* "in its ordinary meaning, it at least involves the concept of a structure with a roof and a support for that roof".

45. A further characteristic of a building is that it can function independently of any other structure. In *Barat v Minister of National Revenue* [1991] 2, CTC 2,360 the court held that a parking garage was a building given the size and permanence of it and the fact it was self-contained and functioned independently of any other structure. However, a building need not be a physically separate structure: *Spencer v Soljan* (1984) 10 NZTPA 289.

46. In *Spencer v Soljan* McMullin J commented (at p 292) that:

> [s]ome semi-detached structures such as terraced houses comprising individual dwellings may each be buildings for the purpose of [section 91 of the Town and Country Planning Act 1977] despite their contiguity with and physical attachment to one another.

47. Also, a structure need not legally be part of the land on which it stands in order to be a building: *R v Swansea City Council ex p Elitestone Ltd* (1993) 66 P & CR 422.

Reasonable person test

48. In deciding whether a structure is a building within the conventional meaning it is appropriate to ask whether a reasonable person would regard the structure as a building based on its appearance. In *Re St Peter the Great, Chichester* [1961] 1 WLR 907, Buckle J accepted (at p 912) that there were three tests to determine what constituted a building.

    (1) Would the ordinary man think this was a building?

    (2) Has the relevant structure four walls and a roof?

    (3) Can one say that the structure is built?

49. Applying these tests, Buckle J concluded that an electricity substation was not a building under legislation that prohibited the erection of any buildings on any disused burial ground except for the purpose of enlarging a place of worship. The substation consisted of a low voltage feeder pillar that was a rectangular metal cupboard with doors just over 4 feet high housing cables and fuses, a transformer just over 6 feet high, and high voltage switchgear comprising eight switches in metal boxes. Buckle J found that the substation met none of the above three tests.

50. In *Harris v De Pinna* (1886) LR 33 Ch D 238 a "reasonable person" test was also applied. In *Harris* the issue was whether a structure used for storing and seasoning timber was a building. The structure consisted of upright baulks of timber fixed on stone bases built on brick piers, with cross-beams and diagonal iron braces, divided into floors or stagings with open unglazed ends between the uprights. Chitty J said (at p 249):

> The proposition I am about to put again is not a decisive one, but I will put it. Would an ordinary man, with a reasonable knowledge of the English language, passing this structure speak of it as a building? I agree that, it is only putting it in a somewhat different form. The question in substance is one of fact and viewing it as a whole and having regard particularly to the model, and by no means disregarding the photographs which I have seen, I have come to the conclusion that this is a structure, but not a building within sect. 3 of the Prescription Act.

51. In *Metals & Alloys Co v Ontario Regional Assessment Commissioner* (1985) 36 RPR 163 a similar approach to *Harris* was taken. The court commented (at para 50):

> "Building", however, is an ordinary English word, and in this statute should be given the meaning an ordinary person would attribute to it. What we have in this case looks like a building. It is almost identical to its neighbouring structure, which is admittedly a building. It is built like a building. It is used like a building … The only reasonable conclusion, in my view, is that it is a building.

52. Therefore, in determining whether a structure is a building, it is appropriate to consider the appearance and function of the structure and to ask whether a reasonable person would regard the structure as a building. This approach is more appropriate than relying on the simple test stated in early cases where it was considered that a structure must have walls and a roof in order to be a building. For example, if the approach in the early cases were applied, the parking building in *Barat v Minister of National Revenue* might not be regarded as a building (because the top floor did not have a roof and the building had only half-walls). However, a parking building would be a building within the ordinary or conventional understanding of that term.

Alternative meanings of "building"

53. The ordinary or conventional meaning of the term "building" includes buildings with the above mentioned characteristics and would be considered buildings by a reasonable person. In some contexts the term "building" could have an alternative meaning. For example, possible alternative meanings could be:

- a wider meaning that includes structures that are 'built'; or
- a narrower meaning that excludes certain types of specialised buildings.

Wider meaning of "building"

54. Buildings and structures are things of substantial size and have a degree of permanence, but not all structures are necessarily buildings: *Cardiff Ruling Authority v Guest Keen Baldwins Iron & Steel Co Ltd* [1969] 1 All ER 27. However, structures (which would not be buildings under the conventional meaning) such as fences, grain silos, tunnels, driveways, tanks, and bleachers have been held to be buildings in some contexts. A New Zealand case where a wider meaning of "building" was adopted was *Chief Executive of the New Zealand Customs Service v Rakaia Engineering & Contracting Ltd* [2002] 3 NZLR 24. In this case the Court of Appeal considered that grain storage bins were buildings under the customs tariff.

55. Other cases in which the wider interpretation of "building" has been adopted include *Buckleigh v Brown* [1968] NZLR 647 (a fence), *Wood v Cooper* [1894] 1 Ch 376 (a trellis screen), *Schweder v Worthing* [1912] 1 Ch 83 (a tunnel), *Clarke v Wilkie* (1977) 17 SASR 134 (a concrete driveway), and *Imperial Oil Ltd v Sherwood (Rural Municipality)* [1922] 2 WWR 1,156 (tanks and bleachers). The structures that were held to be buildings in these cases have some but not all of the characteristics of buildings within the conventional meaning outlined above.

Narrower meaning of "building"

56. In some situations the term "building" may be intended to exclude buildings that are specialised in the sense of the setting they provide or their function or integration with plant or equipment. That is, the ordinary or conventional meaning of "building" is modified to exclude such buildings. This may arise where interpretatively there is an alternative to defining the item as a "building", such as defining the item as "plant".

57. Case law indicates that a building will be considered plant where the building is more than the setting in which business activities take place and plays an essential role in the business process. The building must perform an essential function in the business process before it takes on the characteristics of plant: *Broken Hill Pty Co Ltd v FC of T* (1968) 41 ALJR 377; *Wangaratta Woollen Mills Ltd v FC of T* 69 ATC 4,095.

58. In addition to this, cases decided under the pre-1993 depreciation provisions such as *Colonial Motor Co Ltd v CIR* (1994) 16 NZTC; *Case G11* (1985) 7 NZTC 1,035; and *Lake Pine MDF Ltd v CIR* (1994) 16 NZTC 16 may also indicate that certain buildings should be treated as plant. However, as mentioned earlier, these cases were considered under a different depreciation regime where the Courts were deciding between whether an item was "premises" or "plant". Therefore, the question before the Court was not whether the item was a building or not.

Importance of context

59. The appropriate interpretation of "building" depends on the context in which the word is used. In *Spencer v Soljan*, McMullin J, who delivered the decision of the Court of Appeal, commented (at pp 291–292), "[w] hat is a building for the purposes of one statute may not be a building for the purposes of another". Similar statements were made in *Foster v Fraser* [1893] 3 Ch 158, *Paddington Corporation v AG* [1906] AC 1, *Cobb & Co Ltd v Commissioner of Taxation* (1959) 101 CLR 333, and *Hilderbrandt v Stephen*; *Dew Engineering & Development Ltd v R* [1996] 3 CTC 2,904.

60. A wider meaning of "building" has often been adopted in cases involving legislation or restrictive covenants the object of which is to protect the rights of owners of adjacent properties, but this is subject to the wording of the legislation or particular contract in question. Arguably, it might be suggested that a narrower concept of "building" has been adopted in cases involving legislation that required determining whether an item was part of the premises or something else such as plant. Hence, in determining whether either a wider or narrower meaning of "building" should be adopted in a particular context, it is necessary to consider the purpose of the legislation or contract in question.

Purpose of the depreciation provisions

61. The depreciation provisions provide that buildings are treated differently from other items of depreciable property. To determine what meaning the term "building" is intended to have it is necessary to look at the legislative context. This involves considering the purpose of the depreciation provisions including their development and their connection with the provisions dealing with temporary buildings. In particular, it is appropriate to consider the purpose behind treating buildings differently from other items of depreciable property.

62. The rationale for allowing a deduction for depreciation is that capital assets used in the production of income decrease in value over time and, in line with accounting practice, for tax purposes the cost of such capital assets is set off against income over the life of the assets: *Clifford v IR Commrs* (1966) 10 AITR 229;

Para Handkerchief and Textiles (1964) Ltd v CIR (1992) 14 NZTC 9,125; *Paterson v CIR* (2005) NZTC 19,096; "New legislation – Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006", *Tax Information Bulletin* Vol 18, No 5 (June 2006). The appropriate tax depreciation rate for a capital asset (which is relevant to the calculation of the amount of deduction in respect of depreciation in each year) depends on how long the useful life of the asset is. Therefore, economic depreciation rates are set based on the EUL of items of depreciable property. The Commissioner determines EULs for items of depreciable property through the depreciation rate determinations the Commissioner issues. In this way, buildings that are expected to have a shorter useful life than buildings generally may be provided with a depreciation rate based on a shorter estimated useful life.

63. While at no stage was the term "building" defined for the purposes of the depreciation provisions, there were indications that a building within the ordinary or conventional meaning was the preferred interpretation. These indications are:
    - preserving the prohibition on not allowing losses on the sale or disposal of a building;
    - the list of buildings that the 25% interim loading did not apply to;
    - the policy rationale for the changes to the depreciation method for setting depreciation rates for buildings; and
    - the deduction available under section DB 20 for temporary buildings.

64. First, the officials' report on the Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2004 (2 May 2005) discussed submissions on the bill arguing that losses on disposal of buildings should be deductible. The report acknowledged that there was a case to consider for allowing a general deduction for losses from the sale or disposal of buildings. However, the following two important points were stated in the officials' report, and the submissions were declined.
    - Although buildings may usually be expected to depreciate over time, rates of depreciation are typically low. The market value of buildings is subject to fluctuations and, as a consequence, the value of buildings can be variable. If gains are not taxed when buildings appreciate, there is an argument for not allowing deductions for losses on sale, in order to prevent over-investment in buildings. Although similar issues can arise for other assets, this is likely to be a particularly important problem for buildings because of their low depreciation rates and the volatility of estimates of the value of buildings.
    - There is also a concern that the value of land improvements (including buildings) is normally calculated as the difference between the overall value of a property and the unimproved value of the land. There are tax integrity issues when values are apportioned (between the land and improvements) for tax reasons, rather than their actual value. This issue has the potential to create a significant tax avoidance problem and is exacerbated by the fact that buildings move in and out of the tax base.

65. Secondly, when the interim 25% loading was introduced in 1992 it did not apply to buildings. Most of the types of items that did not qualify for the 25% loading, as set out in the schedule of pre-1993 depreciation rates published in *Tax Information Bulletin* Vol 4, No 9 (April 1993), were buildings within the conventional meaning of that term or were items that formed part of a building within the conventional meaning. The later enacted 20% loading also did not apply to buildings and there was nothing brought into the legislation to clarify that another meaning applied.

66. Thirdly, the officials' issues paper *Repairs and maintenance to the tax depreciation rates* (Policy Advice Division, Inland Revenue Department, Wellington, 2004), which led to the depreciation changes enacted in 2006, states that:
    - the starting point for review of the depreciation rates was that depreciation rates should reflect the actual fall in the market value of assets in order to ensure that, as far as possible, investment decisions are not influenced by tax considerations (at paras 1.12–1.14);
    - for depreciating assets, the depreciation loading increases the present value of depreciation deductions, which reduces the cost of investment and the cost of capital which in turn increases investment (at para 4.11);
    - minor levels of inflation can produce a bias favouring longer-lived relative to shorter-lived assets (at para 5.1);
    - the existing depreciation provisions provide a tax bias in favour of longer-lived assets (at para 4.25); that is, depreciation rates for shorter-lived assets are low in comparison to the rate applicable to longer-lived assets.

67. The policy rationale for distinguishing buildings from other items of depreciable property in these rate-setting provisions is that some evidence suggests that the rate of economic depreciation for buildings differs to the rate for equipment. The United States distinguishes in its statistics on economic depreciation between equipment and structures (which includes buildings).

There is some evidence that for a given useful life, the diminishing value depreciation rate for a building will be less than the rate for an item of equipment with the same estimate of useful life (chapter 4 of the above mentioned officials' issues paper).

68. Another reason for treating buildings differently is that with even moderate rates of inflation, calculating depreciation deductions using historical costs creates a bias between short-lived and long-lived assets. Allowing depreciation loading on shorter lived assets and not on longer lived assets such as buildings was the preferred solution to address this bias. While other classes of asset may also be long-lived and may receive the loading, buildings represent a significant proportion of such assets (chapter 3 of the above-mentioned officials' issues paper).

69. However, the above-mentioned officials' issues paper recognised (at para 5.23) that a "structure" may not be a building and that it may have an economic life more equivalent to plant and equipment. The item on the amendments in *Tax Information Bulletin* Vol 18, No 5 (June 2006) says:

> "Building" is not a defined term in the Income Tax Act 2004. **Guidance on whether a structure is considered a building is given in Inland Revenue's depreciation guides**. The Commissioner is undertaking a project to more clearly define a building.
>
> [Emphasis added]

70. As mentioned, whether the term "building" is considered to mean a building within the conventional meaning of the term or to have some other meaning is dependent on the context in which the term is used. The extrinsic material that has surrounded the depreciation provisions in 1988–1993 and in 2006 shows that buildings within the depreciation provisions are considered to be ones that are generally long-lived and have a characteristic of permanence. Thus, the Commissioner's view is that the interpretation to be given to "building" in the depreciation provisions is one that aligns with the ordinary or conventional meaning of "building" as set out in case law outlined above.

71. Lastly, the existence of a statutory definition for temporary buildings and the deduction available on disposal under section DB 20 for temporary buildings tends to also support an ordinary or conventional meaning of "building" in the depreciation provisions. This follows from the fact that it is only this limited class of building (ones defined as being temporary in nature) that attract a deduction for a loss on disposal. The wider class—all ordinary or conventional buildings—are generally denied any loss under sections EE 39 and EE 48(3). It can be argued that section DB 20 (and its predecessors) would serve no purpose if a narrower interpretation of "building" was adopted. In particular, one category of temporary building are buildings that have been erected, and used, to house specific plant or machinery, and will have to be demolished to remove or replace the plant or machinery. This suggests that these types of building would otherwise fall within the wider class but are permitted special treatment under section DB 20. There would be no reason for section DB 20 if these items (and the other categories of temporary buildings) would in any case be entitled to a loss on disposal under the ordinary loss on disposal rules. This indicates that the three types of buildings covered by the temporary building definition are subject to the treatment that other buildings are given under the depreciation provisions. However, if a temporary building is destroyed, there may be an opportunity to claim a loss on the destruction of the building under section DB 20, which otherwise would not be available.

Relevance of section EE 30 and section EZ 23

72. In the current depreciation regime there are two provisions that refer to plant: section EE 30 and section EZ 23. This raises the question as to whether these two sections are relevant to the interpretation of the meaning of "building" in the depreciation provisions. As seen above, section EE 30 relates to the setting of depreciation rates for items that have an estimated residual market value greater than 13.5% of cost that are either plant or equipment acquired on or after 1 April 2005 or buildings acquired on or after 19 May 2005. Section EZ 23 relates to the setting of depreciation rates for any items that are either plant or equipment acquired before 1 April 2005 or buildings acquired before 19 May 2005 (unless these items are "excluded depreciable property"). However, a building that may also be considered plant will have a rate set according to it **being a building** rather than plant. This is because section EE 26 sets out the appropriate rate setting provisions and directs how a rate will be set for a building, regardless of whether it might also be described as plant.

73. Section EE 26 sets out how section EE 30 fits with the other rate setting provisions. For determining the applicable rate setting provision, section EE 26(1)(d) provides that section EE 30 applies for items that have an estimated residual market value greater than 13.5% of cost where section EE 27 or section EE 28 would otherwise have applied. Section EE 27 applies to items (excluding buildings) acquired on or after 1 April 2005.

Section EE 28 applies to buildings acquired on or after 19 May 2005. Therefore, section EE 30 does not apply to buildings that have an estimated residual market greater than 13.5% of cost acquired before 19 May 2005. Instead, section EE 26(1)(e) provides that such buildings have a rate set under section EZ 23. In this way it is not necessary to determine whether an item is a building or plant. The only question is whether an item is a building, or not a building. Section EE 26 then directs which provisions will apply.

Conclusion

74. For the purposes of the depreciation provisions the Commissioner's view is that the term "building" has an ordinary or conventional meaning. Further, it is the Commissioner's view that the ordinary or conventional meaning of "building" is not modified for the purposes of the depreciation provisions either in terms of being broader to include many built structures, nor to exclude buildings that provide a specialised setting or have a specialised function or purpose or are integrated with plant. In the case of the latter group, for some such buildings (those that are "temporary buildings") section DB 20 provides concessionary treatment by allowing deductions for losses incurred on the destruction of the building. This concessionary treatment would also be available for some buildings that have shorter economic useful lives than buildings in general or are situated at construction sites.

Examples

75. The following is an analysis of examples of items of depreciable property that are listed in the Commissioner's Table of Depreciation Rates. These items are considered in relation to the characteristics common to buildings identified in this Interpretation Statement.

76. The items listed in Table 1 are considered to be buildings for the purposes of the depreciation provisions and have been treated as buildings in the Commissioner's Table of Depreciation Rates.

Table 1: Items considered to be buildings

Buildings and Structures asset category:
Buildings (not specified)
Buildings with prefabricated stressed-skin insulation panels
Buildings with reinforced concrete framing
Buildings with steel or steel and timber framing
Buildings with timber framing
Fowl houses
Grandstands
Hot houses
Pig houses
Shade houses
Tanneries
Agriculture, Horticulture and Aquaculture industry category:
Dairy sheds and yard

77. The items listed in Table 2 are analysed in more detail below in terms of the characteristics common to buildings identified in this Interpretation Statement, in order to clarify whether they should be considered buildings for the purposes of the depreciation provisions.

Table 2: Items reviewed to determine whether they are buildings

Asset class	Industry or asset category	Is the loading currently applied in IR 265?*	Does the analysis conclude that the items in the asset class are typically buildings?	Should the loading be applied to the typical item?
Carparks (buildings and pads)**	Buildings and Structures asset category	Yes	Yes ** (carpark buildings)	No**
Powder dryer buildings	Dairy Plant industry category	Yes	Yes	No
Chemical works	Buildings and Structures asset category	Yes	Yes	No
Fertiliser works	Buildings and Structures asset category	Yes	Yes	No
Barns	Buildings and Structures asset category	Yes	Yes	No
Barns (drying)	Cigarette Manufacturing industry category	Yes	Yes	No
Buildings (portable)***	Buildings and Structures asset category	No	Yes***	No***
Site huts***	Contractors, Builders and Quarrying	Yes	Yes***	No***

* Inland Revenue's *General depreciation rates (IR 265)*

** The existing asset class for "carparks (buildings and pads)" will be split into two asset classes: one for carpark buildings and one for carpark pads that are separate from the carpark building as carpark pads are not considered buildings.

*** The existing asset classes for "buildings (portable)" and "site huts" are to be reviewed to establish whether new asset classes should be created for those items that are not buildings.

78. Some of the asset classes in Table 2 are very broad and include several different items. In these cases, the typical items of depreciable property within the particular asset class are considered. Other asset classes are more specific, and the specific item that the asset class represents is considered. It is acknowledged that the items within a particular asset class vary. Therefore, whether an item of depreciable property is a building will depend on whether the building characteristics apply to the individual item being considered. However, the typical items within each asset class listed in Table 2 are generally considered buildings for the purposes of the depreciation provisions (except for separate carpark pads and certain portable buildings and site huts). It is noted that section 91AAG of the Tax Administration Act 1994 provides taxpayers with the opportunity to apply for a provisional rate if there is no applicable economic rate that applies for their item of depreciable property.

79. Asset classes for other structures such as silos and bunkers and items that are land improvements under schedule 13 such as bridges and tunnels are not considered to be buildings for the purposes of the depreciation provisions. However, there may be buildings associated with some of the land improvements listed in schedule 13. In these cases those buildings would be treated separately as a building for the purposes of the depreciation provisions.

80. Also, structures such as marquees that can be dismantled, relocated and rebuilt easily are not considered buildings because they do not have the characteristics of an ordinary or conventional building because of their lack of permanence. This concept of lack of permanence is discussed below under the discussion of the asset class "buildings (portable)".

Carparks (building and pads)

Description of item

81. The *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) contains the following definition of "car park":

> **n.** Brit. an area or building where cars or other vehicles may be left temporarily

82. This definition indicates that the ordinary meaning of a carpark is an area reserved for parking a vehicle and that area may be situated within a building.

83. The "carparks (buildings and pads)" asset class in the Buildings and Structures asset category in the Commissioner's Table of Depreciation Rates includes carparking structures for vehicle parking purposes, which may be multi-level structures. These carparking

structures are often referred to as "carpark buildings" or "carparking buildings". Each level contains allotted vehicle parking spaces and is accessed by a ramp.

84. Typically, carparking buildings are built on solid foundations and made from reinforced concrete. Each level consists of columns and beams that provide structural support. Carparking buildings are generally not fully enclosed, with lowered walls or barriers around each side of each level and often no roof over the top level.

85. A carparking pad that is a flattened area of hard surface (for example, a concrete, sealed, or paved surface with markings for vehicle parks) on which vehicles can park, and that is not part of a carparking building described above, is likely to be a hardstanding for tax depreciation purposes. Hardstandings are depreciable land improvements as they are listed in schedule 13.

Application of "building" characteristics

86. Despite carparking buildings not often being fully enclosed by walls and a roof, the application of the other characteristics of a building (identified in the statement) to carparking buildings suggests that carparking buildings are buildings within the ordinary or conventional meaning of the term.

Appearance and function test

87. Carparking buildings have the general appearance of conventional buildings despite not being fully enclosed. Also, the function of carparking buildings is to provide parking spaces for vehicles in a multi-level layout that provides shelter for the vehicles (for example from traffic and weather). Therefore, it is considered a reasonable person would regard a carparking building as a building.

88. It is considered that a carparking pad that is not part of a carparking building does not have the appearance of a conventional building.

Case law

89. In the Canadian case *Barat v Minister of National Revenue* [1991] 2 CTC 2,360, Hamlyn TCJ had to decide whether a parking garage was a building for the purposes of a provision disallowing a deduction from the taxpayer's income of the construction, renovation, or alteration costs relating to buildings. Although *Barat v Minister of National Revenue* refers to a parking garage, the item being considered is the same type of structure as the carparking structures described above. Hamlyn TCJ concluded that the parking garage was a building given the size and permanence of it and the fact it was self-contained and functioned independently of any other structure.

Conclusion

90. The application of the characteristics of a building, and the appearance and function test support the conclusion that a carparking building is a building. A review of the case law also supports the conclusion that these structures are buildings. Therefore, it can be said within the "carparks (buildings and structures)" asset class, a carparking building is a building for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply to carparking buildings, and the 20% loading in section EE 31 does not apply to the economic rate for carparking buildings.

91. A carpark pad that is a flattened area of hard surface on which vehicles can park and is not part of a carparking building, is not a building, and instead is likely to be a hardstanding, which is listed in schedule 13 as a depreciable land improvement. Therefore, the 20% loading in section EE 31 applies to the economic rate for carpark pads as described above within the "carpark (buildings and pads)" asset class.

92. These conclusions mean that the existing asset class for "carparks (buildings and pads)" in the Commissioner's Table of Depreciation Rates should be split into two different asset classes: "carpark buildings" and "carpark pads". A new depreciation determination is required to bring these changes into effect.

Powder dryer buildings

Description of item

93. The "powder dryer buildings" asset class is listed in the Commissioner's Table of Depreciation Rates within the "Dairy Plant" industry category. A powder dryer building is a structure that houses a milk powder dryer along with other drying equipment that is used for producing powdered dairy products such as milk and whey powder.

94. Powder dryer buildings are structures of significant size to contain the large drying equipment required for producing milk powder. Powder dryer buildings are generally constructed with concrete wall panels and steel plate roofs and often have specialised air temperature control systems incorporated into the building structure.

95. The Dairy Plant industry category in the Commissioner's Table of Depreciation Rates contains asset classes for the other items of plant and equipment used in the process of producing milk powder. This includes dryers, evaporators, and packing machines.

Application of "building" characteristics

96. The application of the characteristics of a building (identified in the statement) to powder dryer buildings, suggests that powder dryer buildings are buildings within the ordinary or conventional meaning of the term.

Appearance and function test

97. Powder dryer buildings have the general appearance of conventional buildings. Also, the function of a powder dryer building is to house the dryer that is used for producing powder and provide an environment which enables the dryer to operate. Therefore, it is considered that a reasonable person would regard powder dryer buildings as buildings.

Conclusion

98. The application of the characteristics of a building and the appearance and function test support the conclusion that a powder dryer building is a building. Therefore, the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate.

Chemical works

Description of item

99. In the *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) the following definition is provided for "works" within the definition of "work":

> **5** (works) [treated as sing.] chiefly Brit. a place where industrial or manufacturing processes are carried out.

100. This definition indicates that the ordinary meaning of chemical works is a place where chemicals are processed.

101. The "chemical works" asset class is listed in the Commissioner's Table of Depreciation Rates in the Buildings and Structures asset category. However, the Chemical Plant industry category lists the asset classes that relate to the plant and equipment used to process chemicals. Therefore, it is considered that the "chemical works" asset class does not relate to the chemical-processing plant and equipment, and instead relates only to the structures that house the plant and equipment.

102. Items of property classed as "chemical works" are typically large and house some part of the chemical processing plant or equipment. These structures are constructed out of long-lasting materials, such as wood, concrete, or corrugated iron, and have walls and a roof.

Application of "building" characteristics

103. The application of the characteristics of a building (identified in the statement) to chemical works suggests that chemical works are buildings within the conventional meaning of the term.

Appearance and function test

104. Chemical works have the general appearance of conventional buildings. Also, the purpose of a chemical works is to house the plant and machinery involved in chemical processing. Therefore, it is considered a reasonable person would regard chemical works as buildings.

Conclusion

105. The "chemical works" asset class does not apply to plant and equipment used for chemical processing. The "chemical works" asset class applies to structures that house chemical-processing plant and equipment. These structures are typically large, have walls and a roof, and have the general appearance of a building.

106. The application of the characteristics of a building and the appearance and function test support the conclusion that chemical works are buildings. Therefore, it can be said that chemical works are buildings for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate for chemical works as described above within the "chemical works" asset class.

107. Due to the similarity in appearance, construction, and function, the same conclusion applies to the "fertiliser works" and "tanneries" asset classes, which are listed in the Commissioner's Table of Depreciation Rates in the Buildings and Structures asset category. These asset classes relate to the structures that house processing plant and equipment. The asset classes for plant and equipment that may be housed in a fertiliser works are contained within the Chemical Plant industry category. The asset classes for plant and equipment that may be housed in a tannery structure are contained in the Tanning and Fellmongering industry category.

Barns

Description of item

108. The "barns" asset class is listed in the Commissioner's Table of Depreciation Rates in the Buildings and Structures asset category.

109. The *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) contains the following definition of "barn":

n. 1 A large farm building used for storage or for housing livestock. **2** N. Amer. A large shed for storing road or railway vehicles.

110. Barns are typically large structures. They provide dry shelter on farms for things such as livestock, grain, hay, farm vehicles, and equipment. They are constructed out of long-lasting materials, such as wood, corrugated iron, steel, or concrete and have walls and a roof.

Application of "building" characteristics

111. The application of the characteristics of a building (identified in the statement) to barns suggests that barns are buildings within the ordinary or conventional meaning of the term.

Appearance and function test

112. Barns have the general appearance of conventional buildings. Also, the function of a barn is typically to store and protect from the elements livestock, grain, and so on. Therefore, it is considered that a reasonable person would regard a barn as being a building.

Conclusion

113. The application of the characteristics of a building, and the appearance and function test support the conclusion that barns are buildings. Therefore, it can be said that barns are buildings for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate.

114. Due to the similarity in appearance, construction, and function, the same conclusion applies to the "barns (drying)" asset class listed in the Cigarette Manufacturing industry category in the Commissioner's Table of Depreciation Rates.

Buildings (portable)

Description of item

115. The "buildings (portable)" asset class is listed in the Commissioner's Table of Depreciation Rates in the Buildings and Structures asset category. The kind of property that the "buildings (portable)" asset class relates to are structures that provide shelter and that are designed and built to be moveable rather than located in one place. Therefore, such structures are not attached to the ground by permanent foundations and are generally smaller than buildings designed to be located in one location. The extent of mobility varies amongst portable buildings and depends largely on the size of the particular structure.

Application of "building" characteristics

116. Many portable buildings would be of a size comparable to many small permanent buildings. Therefore, the conventional building characteristic of significant size is seen to be met in many cases for portable buildings. In *Stevens v Gourley* (1859) 7 CBNS 99 the shop, which was of "considerable dimensions" but not attached to the earth, was found to be a building.

117. The characteristics dealing with permanence may or may not be met depending on the portability of a particular portable building. Permanence in the sense that a building is designed to be located permanently on the site where it stands is related to its size. For example, the shop in *Stevens v Gourley* was not attached to the ground but was large enough to be considered a building. Therefore, if a portable building cannot be easily moved because of its size and weight (that is, movable only by machinery such as a crane) then the conventional building characteristic of permanence of location is met. Many portable buildings would fit into this category. This is in contrast to the types of things Byles J in *Stevens v Gourley* listed (at page 113) that would not be considered a building because of their portability. These were a bird cage, a wig box, a dog kennel, and a hen coop. Therefore, unlike the shop in *Stevens v Gourley*, which was fixed to the ground by its own weight, a structure that is easily moved from place to place will not be a building within the ordinary or conventional meaning of that term.

118. In *Melfort Danceland* a mobile home was found not to be a building. The mobile home in this case appears to be one that was on wheels. Therefore, a structure that is permanently attached to wheels and is of a size comparable to a caravan or mobile home would lack the characteristic of permanence of location because it is easily moved.

119. Permanence in the sense that a building is intended to last a considerable time was a factor considered alongside the permanence of location factor (ie the degree of portability) in *Stevens v Gourley*. Byles J in *Stevens v Gourley* considered that a building is of considerable size, and intended to be permanent or at least to endure for a considerable time. Byles J then lists items that are considered to be buildings, and those that are not because of their ease of portability (eg, a bird cage, a wig box, etc), which indicates that the more portable (or lightweight) an item the less durable it is.

120. The other two characteristics of conventional buildings, being having walls and a roof, and being able to function independently of any other structure, are likely to be met for most portable buildings. Many portable

buildings are separate and individual structures that have the appearance of a small building (ie have walls, a roof and a door) and so function to provide shelter.

121. The application of the characteristics of a building (identified in the statement) to portable buildings, suggests that those portable buildings that are sufficiently permanent and of a sufficient size and appearance are buildings within the ordinary or conventional meaning of the term.

122. In *Dew Engineering & Development Ltd v R* [1996] 3 CTC 2,904 "modules" connected to one another by bolts to form a laboratory designed to be portable were held not to be a building for the purposes of an exclusion to allowable tax deductions for research and development expenditure. The laboratory was made up of five modules (each of which was made of steel and contained a floor, roof and walls and were described as being almost identical to the components of walkways at Ottawa International Airport) and could be easily and quickly dismantled and relocated. Amongst the reasons for not treating the laboratory as a building was that it lacked permanence in that it was not fixed to the ground, it was easily disassembled and reconstructed, and it was not intended to remain in a particular location. Also, its energy needs were met by connection to the facilities of the structure to which it was appended. (Although these reasons appear to contradict the above points in relation to determining whether a portable building is a conventional building, the context of promoting research and development seem to have influenced the decision that the laboratory was not a building for the purposes of the particular provision. Therefore, it is considered that the case must be viewed with some caution in terms of its applicability in the depreciation context.)

123. To ascertain whether a portable building is sufficiently permanent and of a sufficient size and appearance to come within the meaning of "building" for the purposes of the depreciation provisions the following should be considered:

- whether it is of a size comparable to many permanent buildings (ie requires heavy duty lifting such as a crane to move it);
- the durability of the materials it is made from (ie not too lightweight);
- whether it looks like a building (ie has walls and a door and possibly windows, but does not look like a container or some other item or structure);
- whether it is fixed to the ground (ie not easily moved, at least fixed by its own weight, intended to remain in a particular location, and does not have wheels);
- whether it is designed to be dismantled, relocated and rebuilt easily (ie individual components that are required to be integrated to make the whole structure and are easily moved may not form a building).

Appearance and function test

124. Some portable buildings may not actually fall within the ordinary or conventional meaning of "building" because no reasonable person would consider them to be buildings in the conventional sense. For example, some containers may be used to provide shelter for people or goods, but would not be described as buildings. Therefore, such items are not considered buildings for the purposes of the depreciation provisions.

125. However, containers that have been converted into portable buildings may fall within the conventional meaning of "building" depending on the extent of conversion and their size. For example, something that looks like it could have been derived from a large container but has windows and a door would more likely have the appearance of a conventional building.

126. Also, some portable structures that provide shelter would not be considered conventional buildings by a reasonable person because they are too small and easily moved. For example, most dog houses and many garden sheds would be too small to be considered conventional buildings.

Conclusion

127. The "buildings (portable)" asset class relates to structures that are designed and built to be moveable rather than located in one place. Such items will not be fixed permanently in one location.

128. The application of the characteristics of a building, and the appearance and function test support the conclusion that those portable structures that come within the "buildings (portable)" asset class that are sufficiently permanent and of a sufficient size and appearance will be buildings for the purposes of the depreciation provisions. Therefore, the methods for setting depreciation rates for buildings apply to those items, and the 20% loading in section EE 31 does not apply to the depreciation rate.

129. Those portable structures that may come within the "buildings (portable)" asset class but are too small or otherwise do not have the appearance of a conventional building are not considered buildings for the purposes of the depreciation provisions. This conclusion means that the existing asset class for "buildings (portable)" in the Commissioner's Table

of Depreciation Rates needs to be reviewed to clarify the distinction between these various portable buildings. This may involve creating other asset classes for portable structures that are not considered to be conventional buildings. New depreciation determinations will be required to bring these changes into effect.

Site huts

Description of item

130. The "site huts" asset class is listed in the Commissioner's Table of Depreciation Rates in the Contractors, Builders and Quarrying industry category. The kinds of items that the "site huts" asset class relates to are structures that provide shelter for site workers. Therefore, such structures are designed and built to be moveable from site to site. As such, the "site huts" asset class contains structures that are similar, and in some cases the same as, those structures within the "buildings (portable)" asset class. Such structures are not attached to the ground by permanent foundations and are generally smaller than buildings designed to be located in one location. The extent of mobility varies amongst site huts but in most cases site huts will be of a size that cannot be easily moved without machinery such as a crane.

Application of "building" characteristics

131. As with many portable buildings, many site huts would be of a size comparable to small permanent buildings. Therefore, the conventional building characteristic of significant size is seen to be met in those cases.

132. Most site huts cannot be easily moved because of their size and weight (that is, movable only by machinery such as a crane). The material used in the construction of a site hut, like other portable buildings, would normally be lightweight for ease of transport but normally sufficiently durable for use over multiple relocations. Therefore, the conventional building characteristics of permanence of location and permanence in the sense of intending to last a considerable time are met.

133. The other two characteristics of conventional buildings having – walls and a roof, and being able to function independently of any other structure – are also likely to be met for most site huts. Most site huts are separate and individual structures that have the appearance of a small building (ie walls and a roof with at least a door) and so function to provide shelter.

134. The application of the characteristics of a building (identified in the statement) to site huts, suggests that those site huts that are sufficiently permanent and of a sufficient size and appearance will be buildings within the ordinary or conventional meaning of the term.

135. To ascertain whether a site hut is sufficiently permanent and of a sufficient size and appearance to come within the meaning of "building" for the purposes of the depreciation provisions the same indications as identified above for portable buildings should be considered.

Appearance and function test

136. As with some portable buildings, there may be some site huts that do not fall within the conventional meaning of "building" because no reasonable person would consider them to be buildings in that sense. The same example used above for portable buildings, being containers that provide shelter, is also relevant here.

137. Most site huts would not be considered too small to be conventional buildings by a reasonable person.

Conclusion

138. The "site huts" asset class relates to structures that are designed and built to be relocated to various sites and so have not been fixed permanently in one location.

139. The application of the characteristics of a building, and the appearance and function test support the conclusion that most site huts are sufficiently permanent and of a sufficient size and appearance to be buildings for the purposes of the depreciation provisions. Therefore, the methods for setting depreciation rates for buildings apply to most site huts, and the 20% loading in section EE 31 does not apply to the depreciation rate. A site hut that is considered a building will come within the definition of "temporary building" if it was erected at a construction site and will have to be demolished or removed on or before completion of the construction. In such a case section DB 20 allows a deduction for losses incurred through its destruction.

140. Those site huts that may come within the "site huts" asset class that are too small or otherwise do not have the appearance of a conventional building are not considered buildings for the purposes of the depreciation provisions. This conclusion means that the existing asset class for "site huts" in the Commissioner's Table of Depreciation Rates needs to be reviewed to clarify that this asset class applies to "site huts" that are considered buildings and to determine whether other asset classes should be created for site huts that are not buildings. New depreciation determinations will be required to bring these changes into effect.

Appendix – Legislation

Depreciation provisions

141. Section EE 6 sets out the definition of depreciable property:

EE 6 What is depreciable property?

Description

(1) **Depreciable property** is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—

(a) in deriving assessable income; or

(b) in carrying on a business for the purpose of deriving assessable income.

Subsections (2) to (4) expand on this subsection.

Property: tangible

(2) An item of tangible property is depreciable property if—

(a) it is described by subsection (1); and

(b) it is not described by section EE 7.

Property: intangible

(3) An item of intangible property is depreciable property if—

(a) it is within the definition of **depreciable intangible property**; and

(b) it is described by subsection (1); and

(c) it is not described by section EE 7.

Property: geothermal wells

(4) For the purposes of this subpart, a person who owns a geothermal well is, for the geothermal energy proving period, treated as acquiring the well as property that declines in value and is to be available for use in carrying on a business for the purpose of deriving assessable income.

142. Section EE 7 sets out what is not depreciable property:

EE 7 What is not depreciable property?

The following property is not **depreciable property**:

(a) land, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1):

(b) trading stock:

(c) livestock to which subpart EB (Valuation of trading stock (including dealer's livestock)) applies:

(d) financial arrangements:

(e) excepted financial arrangements:

(f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:

(g) property that its owner chooses, under section EE 8, to treat as not depreciable:

(h) property that its owner chooses, under section EE 38, to deal with under that section:

(i) property for whose cost a person other than the property's owner is allowed a deduction:

(j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under a provision of an earlier Act, except for an asset to which section DU 6(4) (Depreciation) applies.

143. Section EE 26 sets out the relevant provisions for setting economic depreciation rates:

EE 26 Setting of economic depreciation rate

Relevant provisions

(1) The economic depreciation rate that applies to a kind of item of depreciable property is set under—

(a) section EE 27, for items that—

(i) are not buildings, fixed life intangible property, excluded depreciable property, or property for which an economic rate set under section EE 29 or EE 30; and

(ii) are acquired on or after 1 April 2005:

(b) section EE 28, for items that are buildings and—

(i) are acquired on or after 19 May 2005; and

(ii) do not have an economic depreciation rate set under section EZ 23 (Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005):

(c) section EE 29, for certain aircraft and motor vehicles acquired on or after 1 April 2005:

(d) section EE 30, for items that—

(i) have an estimated residual market value greater than 13.5% of cost:

(ii) would, in the absence of section EE 30, have an economic depreciation rate set under section EE 27 or EE 28:

(e) section EZ 23 for items that—

(i) are not buildings, fixed life intangible property, or excluded depreciable property and are acquired before 1 April 2005:

(ii) are buildings acquired before 19 May 2005:

(iii) are buildings acquired on or after 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic depreciation rate set under section EZ 23 or a corresponding provision.

No rate for fixed life intangible property or excluded depreciable property

(2) An economic depreciation rate must not be set for a kind of item of depreciable property that is fixed life intangible property or excluded depreciable property.

Overriding effect of election under section EE 32

(3) Subsection (1)(a), (c), and (d) are overridden by section EE 32.

144. Section EE 28 sets out the method for setting an economic depreciation rate generally for buildings acquired on or after 19 May 2005.

EE 28 Economic rate for buildings

What this section is about

(1) This section is about setting the economic depreciation rate that applies to a kind of item of depreciable property that is a building and for which an economic rate is not set under section EE 30 or EZ 23 (Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005).

Rate set by Commissioner

(2) The Commissioner sets the rate from time to time by—

(a) following the procedure set out in this section; and

(b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

Procedure for setting economic rate

(3) To set the straight-line rate for a kind of item of depreciable property, the Commissioner –

(a) gets a figure by applying the formula in subsection (4) to items of that kind; and

(b) rounds the figure up or down to the nearest rate specified in schedule 11, column 4 (New banded rates of depreciation); and

(c) sets the same rate for some or all of the kinds of buildings that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to—

(i) the rate calculated for each kind; and

(ii) the reduction in compliance costs that is likely to be achieved.

Formula

(4) The formula is—

$$\frac{1}{\text{estimated useful life}}$$

Definition of item in formula

(5) In the formula, estimated useful life is the **estimated useful life** of the item expressed in years.

Contracts existing at 19 May 2005

(6) Despite subsection (1), a person who before 19 May 2005 enters into a binding contract for the purchase or construction of a building must apply to the building the economic rate for the kind of the building determined under section EZ 23.

145. Section EE 30 sets out the method for setting an economic depreciation rate for items that have an estimated residual market value of more than 13.5% of cost:

EE 30 Economic rate for plant, equipment, or building, with high residual value

What this section is about

(1) This section is about setting the economic depreciation rate that applies to items of a kind of depreciable property if—

(a) the kind of depreciable property is not fixed life intangible property, or excluded depreciable property, for which an economic rate cannot be set; and

(b) the estimated residual market value for the item is more than 13.5% of cost; and

(c) the items are—

(i) plant or equipment acquired on or after 1 April 2005:

(ii) buildings acquired on or after 19 May 2005.

Rate set by Commissioner

(2) The Commissioner sets the rate from time to time by—

(a) following the procedure set out in this section; and

(b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

Procedure for setting economic rate

(3) To set the diminishing value rate for a kind of item of depreciable property, the Commissioner—

(a) obtains a figure by applying the formula in subsection (4) to items of that kind; and

(b) rounds the figure up or down to the nearest rate specified in schedule 12, column 1 (Old banded rates of depreciation); and

(c) sets the same rate for some or all of the kinds of items of depreciable property that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to—

(i) the rate calculated for each kind; and

(ii) the reduction in compliance costs that is likely to be achieved.

Formula

(4) The formula is—

$$1 - \left(\left(\frac{\text{residual value}}{\text{cost}} \right) \frac{1}{\text{estimated useful life}} \right)$$

Definition of items in formula

(5) In the formula,—

(a) residual value is the greater of—

(i) estimated residual market value, which is defined in section EE 67:

(ii) 13.5% of cost:

(b) cost is the cost of items of the kind to which the formula is applied:

(c) estimated useful life is defined in section EE 63.

146. Section EE 31 sets out when the 20% loading applies:

EE 31 Annual rate for item acquired in person's 1995–96 or later income year

INTERPRETATION STATEMENT

What this section is about

(1) This section is about the annual rate that applies to an item of depreciable property that a person acquires, other than under section FL 2(2) (Treatment of emigrating companies and their shareholders), in their 1995–96 income year or a later income year (not including fixed life intangible property or excluded depreciable property, for which rates are set in sections EE 33 and EZ 15 (Annual rate for excluded depreciable property: 1992–93 tax year)).

Rate

(2) The rate is 1 of the following:

(a) the item's economic rate, special rate, or provisional rate, for an item not described in either paragraph (b) or (c):

(b) the item's economic rate, special rate, or provisional rate, multiplied by 1.2, for an item that –

(i) has not been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it; and

(ii) is not a building; and

(iii) is not a used imported car; and

(iv) is not an international aircraft:

(c) a diminishing value rate of 15% or a straight-line rate of 10%, for an international aircraft.

147. Section EE 39 sets out depreciation loss that can be claimed on items no longer used:

EE 39 Items no longer used

When this section applies

(1) This section applies when a person in an income year has an item of depreciable property that—

(a) is no longer used or, because the geothermal energy proving period has ended, becomes unavailable for use under section EE 6(4); and

(b) is not a building, unless the item meets the requirements of subsection (2); and

(c) has not been depreciated using the pool method.

Buildings

(2) This section applies to a building that meets the requirements of subsection (1)(a) and (c) if—

(a) the building has been irreparably damaged and rendered useless for the purpose of deriving income; and

(b) the damage occurs—

(i) in the 2005–06 income year or a later income year:

(ii) as a result of the extreme climatic conditions that occurred during the month of February 2004 in New Zealand:

(iii) as a result of the storm event that occurred during the month of July 2004 in the Bay of Plenty area; and

(c) the damage is caused other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

Amount of depreciation loss under this section

(3) The person has an amount of depreciation loss under this section and under no other provision of this subpart.

Circumstances

(4) The person has an amount of depreciation loss if—

(a) they no longer use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(b) neither they nor a person associated with them intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

Amount

(5) The amount of depreciation loss is the item's adjusted tax value at the start of the income year.

Adjusted tax value at end of year

(6) The item's adjusted tax value at the end of the income year is zero.

148. Section EE 48 sets out the depreciation treatment of items disposed of:

EE 48 Effect of disposal or event

Amount of depreciation recovery income

(1) For the purposes of section EE 44, if the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is the amount of depreciation recovery income derived by the person for the income year in which the disposal or the event occurs:

(a) the amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and

(b) the total of the amounts of depreciation loss for which the person has been allowed deductions for the item including, for an item to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies, any deduction allowed for its acquisition.

Amount of depreciation loss

(2) For the purposes of section EE 44, if the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss, for the income year in which the disposal or the event occurs, that is the amount by which the consideration is less than the item's adjusted tax value on that date.

When this section does not apply

(3) Subsection (2) does not apply if the item is a building unless—

(a) the building has been irreparably damaged and rendered useless for the purpose of deriving income; and

(b) the damage occurs—

(i) in the 2005–06 income year or a later income year:

(ii) as a result of the extreme climatic conditions that occurred during the month of February 2004 in New Zealand:

(iii) as a result of the storm event that occurred during the month of July 2004 in the Bay of Plenty area; and

(c) the damage is caused other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

149. Section EZ 23 sets out the method for setting an economic depreciation rate for items that are plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005:

EZ 23 Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005

What this section is about

(1) This section is about setting the economic depreciation rate that applies to items of a kind of depreciable property if—

(a) the kind of depreciable property is not fixed life intangible property, or excluded depreciable property, for which an economic rate cannot be set; and

(b) the items are—

(i) plant or equipment acquired before 1 April 2005:

(ii) buildings acquired before 19 May 2005:

(iii) buildings acquired on or after 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic depreciation rate set under this section or a corresponding provision.

Rate set by Commissioner

(2) The Commissioner sets the rate from time to time by—

(a) following the procedure set out in this section; and

(b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

Procedure for setting economic rate

(3) To set the diminishing value rate for a kind of item of depreciable property, the Commissioner—

(a) gets a figure by applying the formula in subsection (4) to items of that kind; and

(b) rounds the figure up or down to the nearest rate specified in schedule 12, column 1 (Old banded rates of depreciation); and

(c) sets the same rate for some or all of the kinds of items of depreciable property that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to—

(i) the rate calculated for each kind; and

(ii) the reduction in compliance costs that is likely to be achieved.

Formula

(4) The formula is—

$$1 - \left(\left(\frac{\text{residual value}}{\text{cost}} \right) \frac{1}{\text{estimated useful life}} \right)$$

Definition of items in formula

(5) In the formula,—

(a) residual value is the greater of—

(i) estimated residual market value, which is defined in section EE 67 (Other definitions):

(ii) 13.5% of cost:

(b) cost is the cost of items of the kind to which the formula is applied:

(c) estimated useful life is defined in section EE 63 (Meaning of estimated useful life).

150. Section EE 63 sets out the definition of "estimated useful life":

EE 63 Meaning of estimated useful life

Meaning for item of depreciable property, except for copyright in sound recording

(1) **Estimated useful life**, for an item of depreciable property, other than a copyright in a sound recording, means the period over which the item might reasonably be expected to be useful in deriving assessable income or carrying on a business for the purpose of deriving assessable income, taking into account—

(a) the passage of time, likely wear and tear, exhaustion, and obsolescence; and

(b) an assumption of normal and reasonable maintenance.

Meaning for copyright in sound recording

(2) **Estimated useful life**, for a copyright in a sound recording, means the period from the time at which the copyright might reasonably be expected to be first useful in deriving assessable income until the end of the income year in which it might reasonably be expected that 90% of all the income that will be derived from it has been derived.

Temporary buildings provisions

151. Section DB 20 allows a deduction for loss incurred through the destruction of a temporary building:

> **DB 20 Destruction of temporary building**
>
> *Deduction*
>
> (1) A person is allowed a deduction for a loss that they incur through the destruction of a temporary building.
>
> *Link with subpart DA*
>
> (2) This section supplements the general permission and overrides the capital limitation. The other general limitations still apply.

152. Section YA 1 sets out the definition of "temporary building":

> **temporary building** means—
>
> (a) a building that—
>
> (i) is erected under a permit issued by a local authority or a public authority; and
>
> (ii) must be demolished or removed if the local authority or the public authority requires its demolition or removal; or
>
> (b) a building that—
>
> (i) is erected at a construction site; and
>
> (ii) is to be demolished or removed on or before the completion of the construction; or
>
> (c) a building that—
>
> (i) was erected, and is used, to house specific plant or machinery; and
>
> (ii) will have to be demolished to remove or replace the plant or machinery.

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.

TAX DISPUTES NOT A VEHICLE FOR COLLATERAL GRIEVANCES

Case	Clarence John Faloon and Ors v Commissioner of Inland Revenue
Decision date	29 April 2010
Act(s)	Tax Administration Act 1994
Keywords	Collateral grievance, disputes process, abuse of process

Summary

The disputant was unable to convince the court that a long-standing compensation grievance had any basis in the tax disputes process.

Impact of decision

The decision is positive for the Commissioner, it confirms that courts are unwilling to progress the actions of repetitive litigants with misconceived cases. It also confirms the confinement of the disputes process in Part IVA of the Tax Administration Act 1994 to bona fide tax disputes. The process is not a vehicle for collateral grievances.

Facts

Mr Faloon's father was the director of two companies, Trade Lines Limited and Central Equipment Company Limited, which are in liquidation.

Mr Faloon claimed that there was compensation owing on assets which were once owned by the companies. The compensation related to a pipe diversion of a stream by the Palmerston North City Council and the taking of land by the Crown for Airport extensions. He also claimed that he should be compensated by the Commissioner for loss of patent rights which were owned by one of the companies.

Compensation of $80,000 was paid to Trade Lines Limited for the land in December 1993. The compensation was paid in accordance with the requirements of the Public Works Act 1993.

Mr Faloon remained aggrieved over the loss of company assets and claimed that compensation was inadequate. He had been involved in litigation against the Crown and the Commissioner of Inland Revenue for a number of years and despite those claims being rejected by the courts he continued to re-litigate the issues. There have been over 20 proceedings touching on these matters to date.

On this occasion he registered the "1977-Year Diversion of the Kawau Stream Trust" and filed income assessments in March 2009 claiming entitlement to compensation.

The Commissioner refused to accept the assessment and rejected a Notice of Proposed Adjustment (NOPA) filed by Mr Faloon in July 2009.

Mr Faloon then filed proceedings in the High Court claiming the Commissioner was bound to accept his assessment and that he had a right to contest the Commissioner's rejection of his NOPA. He also continued to claim compensation for patent rights.

The Commissioner applied for a strike out of the claim on the grounds of *res judicata*.

Decision

Associate Judge Christiansen held that *res judicata* applied in all causes of action.

In relation to the first at paragraph [30] of the decision, the Associate Judge noted that Mr Faloon "… appears to be unable or unwilling to accept that his own personal claims in respect of either of the two companies have no legal basis".

In relation to the second cause at paragraph [36] he went further and said that the proceeding is an "abuse of process".

The Associate Judge also found that the third cause relating to the patent rights had also been heard before and found against Mr Faloon; *Central Equipment Ltd v CIR* (1986) 8 NZTC 5,031 and *Faloon v Attorney General* (1988) 10 NZTC 5,273.

In summary the proceedings were seen to be "hopelessly misconceived" although the Associate Judge said he was sure that Mr Faloon would continue to "contrive" means to "recast" his case.

Costs were awarded in favour of the Commissioner on an indemnity basis.

COMMISSIONER TO RECONSIDER WHETHER TO ACCEPT LATE OBJECTION

Case	Dunphy and others v Commissioner of Inland Revenue
Decision date	28 April 2010
Act(s)	Income Tax Act 1976
Keywords	Refund, objection, late objection

Summary

The applicants argued that being on the Second Ernst & Young (EY) 'in' List in 1996 was a request for a refund and should have been considered by the Commissioner as an application to accept a late objection, the grounds of the objection being the Rudd Watt & Stone letter in 1986. The Commissioner was directed to reconsider whether to accept the late objections.

Impact of decision

This judgment turns on its specific facts; particularly the EY 'in' List. The taxpayers were investors in the same film investment (Utu) which the Privy Council held in *Peterson v CIR* to not be tax avoidance and the dispute procedure is per the old objection process.

Facts

The three applicants (originally there were eight) were investors in partnerships that financed production of the film Utu. The business affairs of the partnerships were managed by a management committee that operated through Ernst & Young (EY).

The Commissioner audited the partnerships and took the view that certain deductions could not be claimed; broadly because of sham and tax avoidance. Each partner received a letter to that effect.

The management committee instructed Mr Geoff Harley of Rudd Watt & Stone (RWS) who wrote to the Commissioner on 22 December 1986 that he had been instructed to object to the assessments of the partnerships and the partners respectively. This letter is referred to as the "RWS Objection".

The Commissioner responded that the RWS Objection could not be accepted as an objection and a written notice of objection would be required. No individual assessments had been made at the time.

It was informally agreed that the Hay group (other investors in the partnerships that financed production of the film Utu) would have their objections determined first, effectively as a test case.

As time passed and individual partners engaged directly with the Commissioner, the Commissioner questioned the authority of Mr Harley to act for the partners. Mr Harley prepared a list on 23 September 1992 in which the applicants, with others, were identified as having "continuing objections". This is known as the "First EY 'in' List".

In 1996 following an inquiry from Mr Jenkin QC, lead counsel for the Commissioner, an updated list, which included the applicants, was sent to the Commissioner on 20 March 1996—the "Second EY 'in' List".

Following the discontinuance of the Hay proceedings, Mr Richard Peterson independently stated a case for the Taxation Review Authority and continued appealing to the Privy Council which, by majority, found that the arrangement was not tax avoidance; *Peterson v CIR* [2006] 3 NZLR 433.

During the progression of the Peterson case through the Courts, there was no communication between the applicants and the Commissioner. However, following the Privy Council's decision, the three applicants and others approached the Commissioner seeking refunds, either inquiring whether they had live objections or claiming that they did.

Following correspondence and discussions, the Commissioner by his delegate wrote to Mr Harley on 29 September 2008. It was this which was judicially reviewed by the applicants.

Subsequent to the proceedings, a senior tax counsel (STC) in the Department considered whether the Commissioner should accept late objections under section 30(2) of the Income Tax Act 1976 (ITA76) for the three applicants and two other applicants. The STC concluded a late objection would not be accepted from any of the three applicants but, subject to some qualifications, concluded a late objection should be accepted from the two other applicants, who subsequently withdrew from the hearing. Several other applicants had previously withdrawn from the proceeding.

Decision

The Court granted leave for the applicants to amend their pleadings after the hearing bar on one allegation; the Commissioner was also granted leave to file an amended defence. Essentially, the applicants were granted leave to amend their pleadings from one of having extant objections and/or the Commissioner being on notice to one of having late objections considered under section 30(2) of the ITA76.

The Court found that the effect of the Commissioner's decision on 29 September 2008 was to decline a request for a refund and, at least by implication, ignore the possibility that there might be a late objection capable of acceptance under section 30(2). These gave rise to a "statutory power of decision" within section 3 of the Judicature Amendment Act 1972 and the decision was justiciable.

The Court went on to consider the applicability of the Privy Council's decision of Peterson to these applicants; they not being parties to that proceeding. The Commissioner noted that the Privy Council's decision was decided on concessions made by the Commissioner, including the concession that the full costs deducted were economic costs. For different taxpayers, the Commissioner said that he may take a different position in relation to investments in Utu. The Court noted it had considerable difficulty with this:

a) The applicants were members in the same Utu partnerships as Mr Peterson and the ratio of the Privy Council's decision was that the "arrangement" was not tax avoidance.
b) If a matter concerning the partnerships came before the Court, it would be bound by the Privy Council's decision.
c) Any concessions made by the Commissioner to the Privy Council were made during the final phase of the Peterson litigation and it is difficult to believe that the Commissioner's concessions would have been other than fully informed.
d) The Commissioner has applied Peterson to other partners (because the Commissioner agreed they had extant objections) and it would grossly unfair to exclude these applicants from the benefits of the Privy Council's decision.
e) Even though the non-recourse loan gave rise to a secret profit at the investors' expense, they nevertheless incurred a contractual liability to repay the loan out of profits generated by the film.
f) *Ben Nevis*, *Glenharrow* and *Accent Management* [sic] involved different facts. Accordingly, the Court was satisfied in the context of late objections that the Commissioner should have proceeded on the basis that the Privy Council's decision applied to the applicants.

It was common ground that the Commissioner did not consider whether he should allow late objections under section 30(2) of the ITA76. The Court found that the issue of refunds was clearly before the Commissioner. There could be no refund in terms of section 409 in the absence of a timely objection (section 30(1)) or a late objection (section 30(2)). Although a late objection was not expressly mentioned in any of the correspondence to the Commissioner, it was inherent in the case the applicants were putting to the Commissioner. The failure of the applicants to directly raise the issue of late objections did not destroy their argument.

The Court found the Commissioner misdirected himself by failing to consider whether a late objection should be accepted. The Court went on to find that there was an objection capable of qualifying as a late objection.

The applicants' case was that being on the Second EY 'in' List (20 March 1996) coupled with the RWS Objection (22 December 1986) constituted their objection.

The Court found that:

> [79] The only sensible interpretation is that the investors referred to in the list [the Second EY 'in' List] of "Continuing objections" were confirming their objections. … They were now restating their objection in writing at a time where the objection was capable of responding to their assessments. The only problem was that they were outside the one month timeframe.

The RWS Objection (in 1986) provided the grounds for the objection in 1996 (the Second EY 'in' List) and if Inland Revenue officials involved at the time had "properly turned their minds to the matter" this should have been understood by them.

Thus, the Court found there was written notice of objection stating the grounds of objection, albeit it was out of time.

The Court accepted that the Second EY 'in' List constituted a written application for a refund under section 409 of the ITA76. Accordingly, it was within the eight year timeframe.

The Court further commented that the apparent merits of the objections are strong (ie the Privy Council's decision binds) and despite the evidence from the Commissioner that he is unable to calculate the correct assessments and interest now due to the lack of information, the Court preferred the evidence of the applicants that this was overstated.

The Court concluded that this was one of those "rare cases … where acceptance of the applicants' claims was the only reasoned response that the Commissioner could have properly made".

The Court further considered that the STC's consideration of whether to accept late objections did not cure the defects in the Commissioner's decision to not accept the late objections and directed the Commissioner to reconsider the applicants' positions in terms of the amended statement of claim.

DOUBLE TAX AGREEMENT ON PENSIONS NOT DISCRIMINATORY

Case	TRA Decision 7/2010
Decision date	26 April 2010
Act(s)	Income Tax Act 1994, Taxation Review Authorities Act 1994
Keywords	Double tax agreement, pensions, discrimination, unacceptable tax position, jurisdiction TRA

Summary

The Taxation Review Authority (TRA) struck out the taxpayer's complaint of possible discrimination on jurisdictional grounds, but cancelled the shortfall penalties which had been imposed by the Commissioner.

Impact of decision

There are no implications in terms of the decision on the core tax.

Penalties

The decision appears to permit reference to the taxpayer's sincerity and subjective considerations in determining whether a tax position is unacceptable (see paragraphs [76] and [95]). The Commissioner respectfully considers that this is irreconcilable with section 141B(1) of the Tax Administration Act 1994 (TAA), which expressly provides for an objective approach. However, as the decision also notes that the case was "unusual" and "borderline", it is expected that the decision can be considered restricted to its particular facts and that there will be no implications in terms of the approach taken to determining the acceptability of tax positions. It remains the Commissioner's position that taxpayers' sincerity and their subjective considerations are irrelevant to the acceptability or otherwise of their tax positions.

Facts

The taxpayer is a British national and a New Zealand (NZ) tax resident. He received pensions from the United Kingdom (UK) in 2003 and 2004. Under the NZ/UK Double Taxation Agreement (DTA), pensions are taxed in the country of residence (NZ in this case), and not at the source (UK in this case). This treatment differs from most of NZ's other DTAs (which tax at source), and differs from the treatment in the Organisation for Economic Cooperation and Development (OECD) model DTA convention.

The taxpayer did not return the income received from his UK pensions in his 2003 and 2004 tax returns. The taxpayer was subsequently issued with assessments incorporating the UK pension amounts. He was also assessed with shortfall penalties for taking an unacceptable tax position.

The taxpayer challenged the assessments, arguing that:

a) the NZ/UK DTA provides that any difficulties in the application of the DTA will be resolved by mutual agreement between the parties;

b) because NZ taxes income at higher rates than the UK, the taxpayer was disadvantaged in comparison to recipients of pensions from countries other than the UK, and that disadvantage might be unlawfully discriminatory;

c) therefore, because of the possibility of unlawful discrimination, there must be some difficulty or doubt in the application of the DTA; and

d) therefore the Commissioner made a disputable decision in not resolving the difficulty or doubt by mutual agreement under the terms of the DTA.

The taxpayer sought resolution of the "difficulty and doubt" on the application of the treaty, through:

a) an adequate explanation as to why the treatment is lawful;

b) the Commissioner agreeing with the UK revenue that the taxpayer's pension be taxed in the UK and not in NZ; or

c) the Commissioner agreeing to tax the taxpayer's UK pension at the rates of tax applicable in the UK.

In the course of the dispute, attempts were made by the Commissioner to satisfy option a) above, but the taxpayer was not satisfied with the answers provided.

The Commissioner applied to strike out the claim insofar as it related to the assessments on the basis that the TRA does not have jurisdiction to determine the proceedings. The Commissioner argued that resolution of the taxpayer's complaint would require a determination on the discrimination point, an issue that can only be considered by the Human Rights Review Tribunal (HRRT).

The Commissioner accepted that the TRA had jurisdiction to determine whether the shortfall penalties for taking an unacceptable tax position had been correctly imposed.

Decision

Jurisdiction of the Taxation Review Authority

The TRA agreed with the Commissioner that it did not have jurisdiction to determine the taxpayer's complaint. The claim was struck out insofar as it related to the tax assessments.

The TRA noted at [23] and [24] that it does not have jurisdiction to make declarations of inconsistency in terms of the Human Rights Act, it does not have jurisdiction to overturn an assessment on the grounds that the legislative basis for the assessment is discriminatory, and does not have the jurisdiction to direct the Commissioner to enter into bilateral discussions with the UK over the application of the DTA.

The TRA agreed with the Commissioner that the TRA and HRRT are statutory creations and that each operates within defined statutory frameworks:

i) The resolution of complaints of alleged discrimination is, in the first instance, the task of the Human Rights Commission (HRC).

ii) In the event the HRC is unable to resolve such complaints, they are to be determined by a specialist judicial body, namely the Tribunal.

iii) Where the complaint concerns the interpretation and/or application of an enactment, the only available remedy is a declaration of inconsistency. Acts cannot be defeated or misapplied by reason of such inconsistency.

iv) The TRA's function is to determine challenges to the correctness of assessments made by the Commissioner.

v) Correctness is not a discretionary matter. The TRA has no dispensing power.

While the claim was struck out for lack of jurisdiction, the TRA noted, obiter, that the assessments appeared to be correct in any case.

Shortfall penalties

The TRA disagreed that the taxpayer had taken an unacceptable tax position, and cancelled the penalties that the Commissioner had assessed, stating:

> [95] I do not find the stance of the disputant in this case to be unacceptable. As I have indicated above, viewed objectively it is understandable that this disputant thinks he is correct on the issues dealt with above. A Court needs to give serious consideration to the matters raised by the disputant in this case. They are not simple issues. I think his arguments are sufficient to support a reasonable expectation for him that he could have succeeded. The factors to be considered under section 141B(7) of the TAA do not alter that view of mine. Although it is a little difficult for the disputant to meet the standard of being about as likely as not to be correct, this unusual case can be regarded as borderline and enabling a robust approach to the issue of shortfall penalties.

STRUCK-OFF COMPANY HAS NO LEGAL CAPACITY

Case	TRA 002/02 Decision Number 006/10
Decision date	23 April 2010
Act(s)	Tax Administration Act 1994, Taxation Review Authorities Act 1994, Companies Act 1993
Keywords	Struck-off litigant, capacity

Summary

A struck-off company has no legal status and cannot appear before the Taxation Review Authority (TRA); regardless of this, on the facts as found by the TRA there was no issue to address.

Impact of decision

This case is a re-statement of the law relating to the status of struck-off companies.

Facts

The TRA had previously made an order by consent that the Commissioner refund $7,819.12 to the taxpayer company. The taxpayer alleged the refund had not been made and sought an order from the TRA for the refund and also costs or "a penalty" of either $10,000 or $100,000. It also sought a further goods and services tax (GST) refund which was not the subject of any proceedings before the TRA.

The Commissioner denied the allegation and adduced affidavit evidence showing the refunds had been made (and use of money interest also paid). In addition the taxpayer company was struck off the Companies Register and had not been reinstated.

Decision

The TRA accepted the Commissioner's submission that a struck-off company was incapable of beginning proceedings; paragraphs [13–22]:

> It is settled law that the objector has no legal existence. The objector lacks any capacity to bring or proceed with this application. (paragraph [21])
>
> … the so-called company currently has no status before this Authority because it is a struck off company. (paragraph [31])

Regardless of this, the TRA accepted the Commissioner's evidence that the refunds had been made to the taxpayer and therefore there was nothing for the TRA to address (paragraphs [9–12]):

> It seems to me that, on the balance of probabilities, there has been full compliance by the respondent Commissioner with my Order … (paragraph [30])

The Authority accepted it lacked any jurisdiction to award costs or "a penalty" against the Commissioner (paragraph [6]).

It rejected a complaint by the taxpayer's agent that the Commissioner had the "wrong" witness confirming that:

> ... it is not for an opposing litigant (here the objector) to decide who should be called as witnesses by the defendant ... (paragraph [29])

The Authority accepted that the further GST refund issue was not within its jurisdiction (paragraph [32]).

COMMISSIONER'S RIGHT TO WITHHOLD PAYMENTS

Case	Riccarton Construction Ltd v CIR
Decision date	20 March 2010
Act(s)	Goods and Services Tax Act 1985; Tax Administration Act 1994
Keywords	Section 46, request for further information, letter to investigate, cannot request documents that are not in existence, taxpayer's NOPA not issued in time, validity of NOPA, deemed acceptance, no relief granted

Summary

The Court did not exercise its jurisdiction to grant relief to the taxpayer's judicial review application. The Court held that the Commissioner was not yet satisfied with the goods and services tax (GST) return and could continue to withhold payment. The Court also held that although the taxpayer's Notice of Proposed Adjustment (NOPA) was valid and the Commissioner should have issued a Notice of Response (NOR), as the contract to which it related had been cancelled, relief was not granted.

Impact of decision

Given that the *Contract Pacific* case is to be argued in the Supreme Court this year it is unclear what precedential value this judgment will have in respect of section 46 of the Goods and Services Tax Act 1985 (GSTA). At present the judgment is authority for the proposition that a timely request for information in terms of section 46 suspends the 15-day period in section 46(5) within which the Commissioner must notify intention to investigate.

The Commissioner cannot use section 46 to compel a taxpayer to create a document that is not in existence (in this case, a valuation).

The judgment highlights the desirability of the Commissioner following the disputes process even in circumstances where the Commissioner considers the taxpayer's NOPA to be invalid or not to be a NOPA at all.

Facts

Riccarton Construction (Riccarton) entered into four agreements for the sale and purchase of existing motels. Riccarton's asserted plan was to unit title them, refurbish them and then on-sell them as individual units. Each agreement had a delayed settlement date of about 11 and a half months and required the vendor to provide an invoice to Riccarton. Riccarton immediately claimed the input tax while the vendors, who were registered for goods and services tax (GST) on a payments basis, would only account for GST if and when payment was received.

The Commissioner was not satisfied with the GST returns and withheld the claimed input tax under section 46 of the GSTA for each of the relevant GST periods.

This case concerns two of those four agreements.

Relevant facts for the first agreement

For the first agreement, the Commissioner issued a letter requesting further information within the 15-day period under section 46 and withheld the GST refund. He requested, among other things, a recent valuation. Riccarton replied to the request on 30 October saying that a valuation did not exist. On 4 November 2009, the Commissioner replied saying the return had now been selected for investigation. 4 November was more than 15 days from when the return was filed.

The Commissioner obtained an independent valuation and then reached a compromise with Riccarton that it would pay a partial refund based on the valuation (which was $3 million less than the price). Riccarton issued a NOPA for the balance. The Commissioner's Notice of Response (NOR) rejected the NOPA because it was not issued in time and there was no valid tax invoice (the GST number on the invoice was wrong).

Relevant facts for the fourth agreement

Riccarton filed its GST return, claiming net input tax of $736,763.72 for the period. The return included input tax of $750,000 in respect of the purchase of a motel. The Commissioner issued a timely notice of intention to investigate and withheld the refund under section 46. Riccarton then issued a NOPA claiming an adjustment of $750,000 requiring the Commissioner to refund the GST that had already been claimed in the return. The Commissioner did not issue a timely NOR or a letter rejecting the NOPA. The Commissioner argued that the NOPA was not a NOPA in that it did not propose an adjustment.

Decision

Issue 1

The Court held (at paragraph 39) that the 4 November letter was not out of time because the earlier request for information suspended the other timeframes in section 46. Despite the terms of the judgment, this was not an argument that was advanced by the Commissioner. The Commissioner argued, in line with *Contract Pacific*, that a notice of investigation that is issued outside of the time limit in section 46 does not invalidate the Commissioner's right to withhold a refund under a timely request for information.

The Court did go on to hold that once a timely request for information has been made pursuant to section 46, the refund is payable only when the Commissioner has determined that it is; a condition that was not met.

The Court dismissed the Commissioner's argument that as the valuation that had been requested had not been provided, the request for information remained alive and unmet. The taxpayer did not hold a valuation and section 46 cannot be used to oblige the taxpayer to obtain a valuation.

Issue 2

The Court held that Riccarton's NOPA under the first agreement was issued out of time. The return was filed on 30 September 2008 and the NOPA was issued on 19 June 2009. The date of the filing of the return (not the later letter) was the operative date.

Issue 3

The Commissioner's earlier NOPA based on an invalid tax invoice was valid.

Issue 4

The Court held, following *Alam and Begum*, that points of invalidity can be taken in the disputes process but in the interim the form of the document governs the process. However, in judicial review proceedings the Court did have the power to consider the validity of the NOPA.

Essentially, because the amount of the return for the period ($736,763.72) differed from the amount claimed in the NOPA ($750,000.00) the Court held that the NOPA was a genuine effort to adjust the return.

The Court held that had the NOPA restated the sum claimed in the original return it would have agreed with the Commissioner that it was not a NOPA. That not being the case the Court held there was deemed acceptance by the Commissioner.

Issue 5

Should relief be granted?

The Court exercised its discretion to decline relief on the basis that the agreement to which the NOPA related had been cancelled.

QUESTIONS WE'VE BEEN ASKED

QB 10/03: FRINGE BENEFIT TAX – VALUE OF MOTOR VEHICLE PREVIOUSLY OWNED BY THE EMPLOYER OR BY AN ASSOCIATED PERSON OF THE EMPLOYER

This item applies to FBT periods beginning on or after the first day of the 2008/2009 income year and replaces the Question We've Been Asked, "FBT cost price of secondhand motor vehicle obtained from associated person", published in *Tax Information Bulletin*, Vol 7, No 2 (August 1995) at page 31 from the same date.

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

Question

1. For fringe benefit tax (FBT) purposes, in what situations will the value of a motor vehicle owned by an employer be affected by the vehicle having previously been owned by the employer or an associated person of the employer?

Answer

2. The value for FBT purposes of a motor vehicle owned by an employer is determined on the basis of either the cost price or the tax value of the vehicle to the employer. Generally, the starting point for both of these bases is the actual cost price of the vehicle to the employer - the cost price is the actual cost price to the employer, and the tax value is the actual cost price to the employer less the total accumulated depreciation of the vehicle.
3. The appropriate starting point to value the vehicle for FBT purposes will not necessarily be the actual cost price of the vehicle to the employer if, in the two years before the employer most recently acquired the vehicle, the vehicle was owned by:
   - the employer; or
   - a person associated with the employer at the time the person owned the vehicle.
4. If the cost price method is to be used, the starting point will be the highest cost paid for the vehicle by the employer or the associated person on any acquisition.
5. If the tax value method is used, the appropriate starting point is determined by clause 4 of Schedule 5 of the Income Tax Act 2007. More information on the application of clause 4 is in *Tax Information Bulletin*, Vol 19, No 3 (April 2007), page 81.

Explanation

Purpose of this item

6. This item explains the application of clauses 3(c) and 8(b) of Schedule 5 of the Income Tax Act 2007 ("the provisions").
7. Clause 1 of schedule 5 states that the value of the benefit that an employee receives from having a vehicle provided or available for their private use can be determined on the basis of either the cost price or the tax value of the vehicle.
8. Clause 3(c) applies to employers using the tax value basis and states:

   > 3 In this schedule, a motor vehicle's tax value in a quarter, tax year, or income year is—
   >
   > …
   >
   > (c) determined under clause 4 if, in the period of 2 years before the vehicle's acquisition by the person (**person A**) providing it to the employee, the vehicle is owned by person A or by a person (**person B**) associated with them.

   Clause 4 determines which clause is used to calculate the tax value of the vehicle depending on the basis most recently used to value the vehicle and the owner of the vehicle when that basis was used.
9. Clause 8(b) applies to employers using the cost price basis and states:

   > 8 To determine the value of a benefit under clause 1—
   >
   > …
   >
   > (b) if, in the period of 2 years before the vehicle's acquisition by the person providing it to the employee, the vehicle is owned by the person or by someone associated with them, the cost price is treated as being the highest one of the cost prices paid for the vehicle by the person or an associate since its manufacture:
10. The provisions are anti-avoidance provisions aimed at ensuring FBT liability is not reduced by an employer selling and repurchasing a vehicle at market value so as to take advantage of a lower cost price of the vehicle.
11. A Question We've Been Asked, "FBT cost price of secondhand motor vehicle obtained from associated person", was published in *Tax Information Bulletin*, Vol 7, No 2 (August 1995) at page 31. This Question We've

Been Asked stated that the predecessor to clauses 3(c) and 8(b) applied:

> when the vehicle is purchased from an associated person within 24 months of the date on which that associated person purchased the vehicle.

12. The Commissioner considers that the statement quoted above is incorrect and wishes to clarify the situation.
13. It is timely to do this now, because clause 3(c) was recently amended by section 580 of the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009.

How the provisions apply

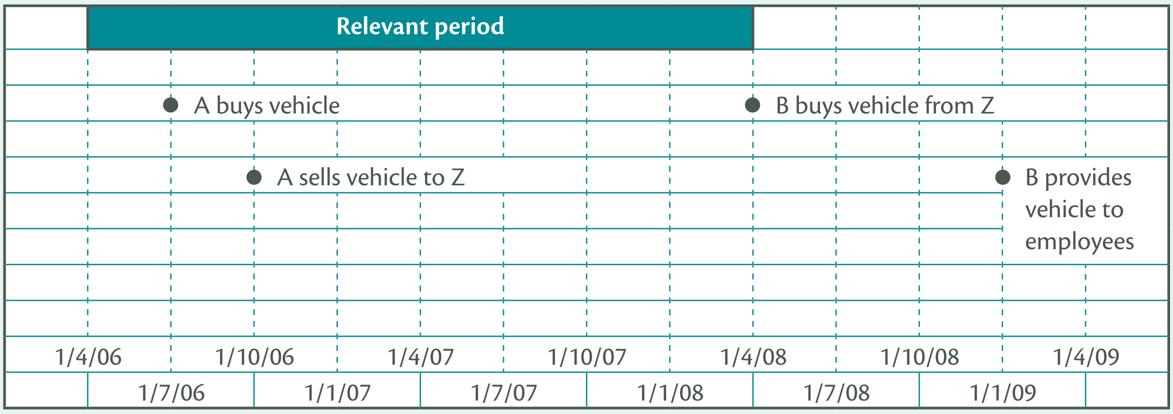
14. This section explains how the provisions are interpreted by answering specific questions that have arisen when the provisions have been applied. Three questions are answered below:
    - What is the relevant period set out by the provisions?
    - When do the parties need to be associated for the provisions to apply?
    - Does it matter how the employer acquired the vehicle?

What is the relevant period set out by the provisions?

15. The provisions focus on "the period of 2 years before the vehicle's acquisition by the person providing it to the employee". This is the two years immediately before the employer most recently acquired the vehicle. This point is illustrated in example 1.
16. Previously, clause 3(c) stated the period as "2 years before a person … acquired the vehicle and provided it to the employee". This could have suggested that the relevant period was the two years before the vehicle was provided to the employee. Clause 3(c) was amended by section 580 of the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009 to clarify that this interpretation is incorrect.

Example 1

17. Company A and Company B have been associated since 2001. Company A bought a motor vehicle on 1 July 2006 and sold it to an unrelated party (Company Z) on 1 October 2006. On 1 April 2008, Company B bought the motor vehicle from Company Z. Company B did not begin to provide the vehicle to one of its employees until 1 January 2009.
18. The transactions in this example are illustrated in the following timeline.



19. The relevant period in the situation described above is 1 April 2006 to 31 March 2008. The vehicle was owned by an associated person of Company B during this period, so Company B will need to determine the value of the motor vehicle provided to the employee using:
    - clause 3(c), if using the tax value basis; or
    - clause 8(b), if using the cost price basis.
20. The following are not important in determining the relevant period:
    - when Company A acquired the vehicle; and
    - when Company B began to provide the vehicle to one of its employees.

When do the parties need to be associated for the provisions to apply?

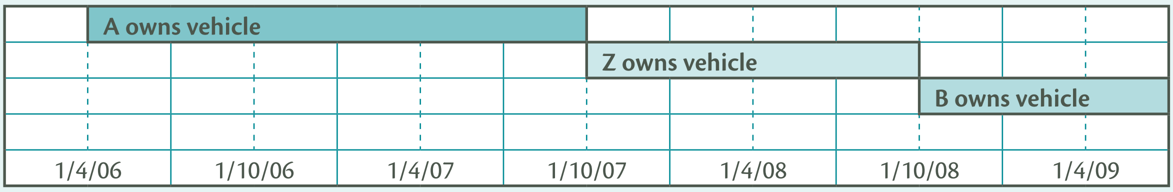
21. The provisions address the situation of a vehicle that has been previously "owned by" the employer or an associated person of the employer. Therefore, for the provisions to apply, the parties must have been associated at a time that was both:
    - during the relevant two year period; and
    - during the time that the associated person owned the vehicle.
22. The parties do not need to be associated when either one acquires the vehicle or when the employer provides the vehicle to an employee. This point is illustrated in example 2.

Does it matter how the employer acquired the vehicle?

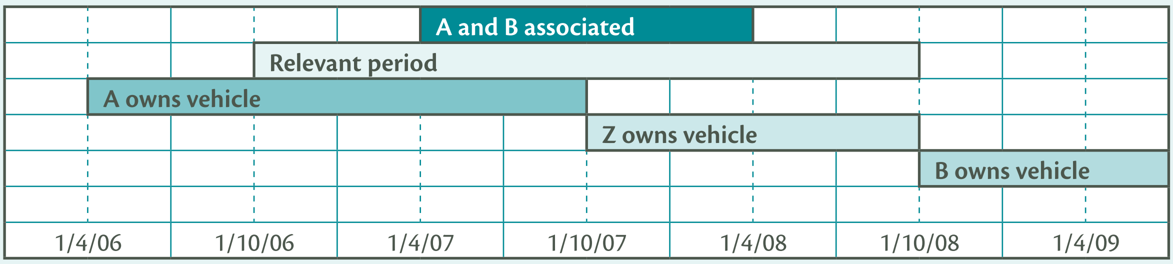
28. The provisions do not refer to how the employer acquires the vehicle, only to the time of acquisition. The provisions do not require that the employer acquire the vehicle directly from the associated person.
29. The provisions also cover situations where one or more unrelated parties own the vehicle in between the associated parties owning the vehicle.
30. The two examples above are both situations where a non-associated person has owned the vehicle between the associated parties. The provisions apply to both of these situations.

Example 2

23. Company A purchased a motor vehicle on 1 April 2006. On 1 April 2007, Company A and Company B became associated persons. On 30 September 2007, Company A sold the vehicle to an unrelated party (Company Z). On 31 March 2008, Company A and Company B ceased to be associated persons. On 1 October 2008, Company B purchased the vehicle from Company Z.
24. For the provisions to apply to this situation, there must have been a time that was:
    - during the period the parties were associated; and
    - during the two year period immediately before Company B acquired the vehicle; and
    - during the period Company A owned the vehicle.
25. The transactions in this example are illustrated in the following timeline.



26. If the period in which Company A and Company B were associated and the relevant period (the two years before Company B acquired the vehicle) are added to the timeline above, then the timeline looks as follows:



27. It can be seen that from 1 April 2007 to 30 September 2007 the parties were associated and Company A owned the vehicle. These dates also fall within the relevant period. Therefore, the provisions apply to this situation. Company B will need to determine the value of the motor vehicle provided to the employee using:
    - clause 3(c), if using the tax value basis; or
    - clause 8(b), if using the cost price basis.

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