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TAX INFORMATION Bulletin

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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
ED0128	Draft depreciation determination – Marine fender systems	This draft determination will add the new asset class of "Marine Fender Systems" to the "Building and structures" asset category. The new rate will apply from the 2009–2010 and subsequent income years. Marine fender systems are attached to wharves. Their function is to absorb large amounts of kinetic energy and to protect vessels moored or being moored to the wharf from damage should the vessel collide with the wharf.	31 August 2010
XPB0012	Local authority rates apportionments on property transactions where the rates have been paid beyond settlement or are in arrears – Goods and services tax implications for vendors and purchasers	These rulings address the question of how apportionments of local authority rates made in property transactions should be treated for GST. BR Pub 10/xa and BR Pub 10/xb apply to situations where the rates have been prepaid by the vendor beyond settlement. BR Pub 10/xc and BR Pub 10/xd apply to situations where the local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding amount, in exchange for a credit against the settlement amount for the vendor's share of the outstanding amount.	

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Judicial review of assessments refused 43

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Contractor not a party to a sham 47

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Discovery rights remain notwithstanding the evidence exclusion rule 48

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Taxpayer fails in attempt to re-litigate claim 50

The taxpayer had a claim in the High Court struck out due to having previously failed in the Court on the same issue. An attempt to have the strike-out reviewed failed.

Standard practice statements

SPS 10/01: Recording Inland Revenue interviews 51

Inland Revenue may use technology to record interviews. This standard practice statement sets out the general principles that apply when technology is used. SPS 10/01 applies from 1 July 2010 and replaces SPS INV-330 *Tape-recording Inland Revenue interviews*.

SPS 10/02: Imaging of electronic storage media 54

This standard practice statement sets out Inland Revenue's practice when taking an image of a taxpayer's electronic storage media. This SPS has been produced to establish Inland Revenue's standards for imaging electronic storage media and to ensure that Inland Revenue performs that function efficiently, effectively and consistently.

SPS 10/03: Acceptance of late objections under section 92(2) of the Child Support Act 1991 61

This standard practice statement 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.

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QB 10/05: Section 78(3) of the Goods and Services Tax Act 1985 64

For section 78(3) to not apply when the GST rate increases from 1 October 2010, there must be an explicit statement in the Act or regulation that the amount charged must not be increased by the change in the GST rate..

NEW LEGISLATION

TAXATION (BUDGET MEASURES) ACT 2010

The Taxation (Budget Measures) Bill was introduced under urgency on 20 May 2010. At the Committee of the Whole House stage, the Bill was split by Supplementary Order Paper No 124 into six amending Acts: the Taxation (Budget Measures) Act 2010, Government Superannuation Fund Amendment Act 1969 Amendment Act 2010, National Provident Fund Restructuring Amendment Act 2010, Social Security Amendment Act 2010, War Pensions Amendment Act 2010, and the New Zealand Superannuation and Retirement Income Amendment Act 2010. The resulting legislation was enacted on 27 May 2010.

The new legislation gives effect to tax reforms announced in Budget 2010, including personal and company tax cuts, a rise in the GST rate and changes to the investment property rules.

PERSONAL TAX CUTS

Sections CS 1, HM 58, LC 3, LC 4, ML 2(1), RC 5(4), RC 8(9), RC 10(3)(a), RC 11(4), RD 50 to 53, RD 58 to 61, RZ 3 to RZ 5C, YA 1, schedule 1, part A, table 1, schedule 1, part C, table 1, schedule 1, part D, tables 1 to 5, schedule 2, part A, schedule 2, part B, table 1, schedule 4, part I, schedule 6, tables 1 and 2 of the Income Tax Act 2007; sections 28C and 33C(c) of the Tax Administration Act 1994

Under changes enacted in the Taxation (Budget Measures) Act 2010, personal income tax rates are being reduced from 1 October 2010.

To ensure that the effects of the tax cuts flow through the tax system appropriately, other consequential amendments to the tax Acts have been made. The Taxation (Budget Measures) Act 2010 therefore amends fringe benefit tax rates, secondary employment codes, withholding tax rates for casual agricultural employees and election day workers, extra pay rates, employer superannuation contribution tax rates, portfolio investment entity rates, resident withholding tax rates, retirement superannuation tax rates, withholding rates for some Māori authority distributions, ACC attendant care withholding rates, child taxpayer tax credits and transitional circumstances tax credits. Transitional provisional tax rules for individual taxpayers are also provided.

Redundancy payment tax credits are being removed from 1 October 2010 and officials have recommended that fund withdrawal tax be repealed from 1 April 2011.

Key features

The Income Tax Act 2007 and the Tax Administration Act 1994 have been amended to provide for tax cuts for individuals from 1 October 2010. The main features of the changes are:

- The new tax rates apply to income earned by individuals from 1 October 2010.
- The bottom tax rate will be lowered from 12.5% to 10.5%, the 21% rate to 17.5%, the 33% rate to 30%, and the highest rate lowered from 38% to 33%.
- Consequential changes to other aspects of the tax legislation—such as PAYE and provisional tax, resident withholding tax rates for interest income, portfolio investment entity tax rates, and fringe benefit tax—will be made to coincide with these changes.
- Some withholding tax rates remain unchanged (for example, the 19.5% tax rate for Māori authorities, the tax rate for non-resident seasonal workers and certain withholding tax rates such as payments to horticultural contractors). These rates will be reviewed at a later date as it is not yet clear what rates would be appropriate for these payments.

Application dates

The changes generally apply from 1 October 2010.

The new composite income tax rates apply for the 2010–11 income year.

Officials have recommended that fund withdrawal tax be repealed from 1 April 2011.

Detailed analysis

Composite income tax rates for the 2010–11 income year (schedule 1, part A, table 1 of the Income Tax Act 2007)

Income tax is calculated based on a person's annual income. Because the tax rates are changing part-way through the 2010–11 income year, the new tax rates that apply for the whole of the 2010–11 income year are "composite tax rates" that reflect an average of the two income tax rates that are used during the year. The table below shows the income

NEW LEGISLATION

tax rates to be used during the 2010–11 income year as well as the composite tax rates for the year. The new composite rates are contained in schedule 1, part A, table 1 of the Income Tax Act 2007.

Income tax rates and composite tax rates for 2010–11 income year

Income range	Old tax rates applying to PAYE for the period 1 April 2010 – 30 Sept 2010	New tax rates applying to PAYE for the period 1 Oct 2010 – 31 March 2011	Composite tax rates for the 2010–11 income year
$0–$14,000	12.5%	10.5%	11.5%
$14,001–$48,000	21%	17.5%	19.25%
$48,001–$70,000	33%	30%	31.5%
$70,001 and over	38%	33%	35.5%

Income tax rates for the 2011–12 and future income years (schedule 1, part A, table 1 of the Income Tax Act 2007)

Schedule 1, part A, table 1 of the Income Tax Act 2007 provides for new income tax rates for the 2011–12 and future income years.

Income tax rates for the 2011–12 and future income years

Income range	Tax rate
$0–$14,000	10.5%
$14,001–$48,000	17.5%
$48,001–$70,000	30%
$70,001 and over	33%

PAYE rates: M and ML tax codes

The new income tax rates apply to PAYE for the first pay period that ends on or after 1 October 2010. For pay periods that span the 1 October date and are for one month or less, PAYE should be deducted at the new rates. If the pay period spanning 1 October is longer than a month, PAYE should be deducted at the old rate for the portion of the pay period before 1 October and at the new rate for the portion of the pay period after 1 October.

PAYE rates from 1 October 2010

Income range	Tax rate
$0–$14,000	10.5%
$14,001–$48,000	17.5%
$48,001–$70,000	30%
$70,001 and over	33%

Inland Revenue's PAYE deduction tables will be updated so the M and ML tax codes reflect the new rates.

PAYE rates: Secondary employment income (schedule 2, part A of the Income Tax Act 2007)

Schedule 2, part A of the Income Tax Act 2007 reduces withholding tax rates on secondary employment income to reflect the new tax rates. This applies from the first pay period that ends on or after 1 October 2010.

PAYE rates from 1 October 2010: Secondary employment income

Income range	Tax code	Tax rate
$0–$14,000	SB	10.5%
$14,001–$48,000	S	17.5%
$48,001–$70,000	SH	30%
$70,001 and over	ST	33%

Extra pays (schedule 2, part B, table 1 of the Income Tax Act 2007)

Lump sums earned in the course of employment ("extra pays") are generally taxed at the employee's marginal rate. Schedule 2, part B, table 1 of the Income Tax Act 2007 will reduce withholding tax rates on extra pays to reflect the new marginal tax rates. These will apply from the first pay period that ends on or after 1 October 2010.

Tax rates for extra pays

Income range	Tax rate
$0–$14,000	10.5%
$14,001–$48,000	17.5%
$48,001–$70,000	30%
$70,001 and over	33%

PAYE rates: Casual agricultural employees and election day workers (schedule 2, part A of the Income Tax Act 2007)

Schedule 2, part A of the Income Tax Act 2007 reduces withholding tax rates for casual agricultural employees and election day workers. The rate is dropping from 21% to 17.5%, to reflect the second-to-lowest marginal tax rate and applies from the first pay period that ends on or after 1 October 2010.

Resident withholding tax rates on interest income for individuals (schedule 1, part D, table 2 of the Income Tax Act 2007)

Schedule 1, part D, table 2 of the Income Tax Act 2007 provides for new resident withholding tax (RWT) rates for individuals who receive interest income. These reflect the new personal tax rates of 33%, 30%, 17.5% and 10.5%.

Row 1 of schedule 1, part D, table 2 replaces the previous 38% RWT rate that applied if a person had not supplied their interest payer with their tax file number with a 33% rate, to align with the new highest marginal tax rate.

Row 2 of schedule 1, part D, table 2 introduces a new 33% default rate from 1 October 2010 for people who have opened a new account with an interest payer after 31 March 2010 but do not elect a tax rate.

Row 5 of schedule 1, part D, table 2 provides for a 17.5% default rate from 1 October 2010 for people who have not opened a new account after 31 March 2010 and have not made a tax rate election.

Additionally, table 2 sets out transitional rules so that people who elected rates before 1 October 2010 shift automatically on that date to the relevant new RWT rates.

The new rates apply from 1 October 2010.

Consequential change to resident withholding tax rates on interest income for companies (schedule 1, part D, table 3 of the Income Tax Act 2007)

Schedule 1, part D, table 3, rows 3 and 4 have been amended to reflect changes to personal income tax rates. This reduces the rate of resident withholding tax from 38% to 33% for interest paid to a company when the recipient of the interest has either elected for the top personal rate to apply or has not supplied their tax file number to the payer.

The change applies from 1 October 2010.

Portfolio investment entity (PIE) rates (sections HM 58, YA 1 and schedule 6, table 1 of the Income Tax Act 2007)

Schedule 6, table 1 has been amended to lower the tax rates that apply to investors in portfolio investment entities (PIEs).

PIE tax rates

Taxable income	Taxable + PIE income	PIE tax rate
$0–$14,000	$0–$48,000	10.5%
$0–$14,000	$48,001–$70,000	17.5%
$14,001–$48,000	$0–$70,000	17.5%
$48,001 and over	Any	28%
Any	$70,001 and over	28%

Section HM 58 ensures that people who invest in PIEs before 1 October 2010 will automatically shift to the new equivalent rate on 1 October 2010, so that they do not need to re-elect their rate with the PIE.

The changes apply from 1 October 2010.

Provisional tax (sections RZ 3 to RZ 5C and YA 1 of the Income Tax Act 2007)

Changes to sections RZ 3 to RZ 5 amend the formulas used to calculate provisional tax and allow individuals who pay provisional tax based on the earlier year method to reduce their provisional tax payments from 1 October 2010.

To calculate provisional tax from 1 October 2010 that is paid on the basis of an earlier year's residual income tax (RIT), transitional factors apply.

The following table provides adjustments to the transitional factors for individuals on the standard and the GST ratio methods for calculating provisional tax for the 2010–11 or later income years.

Adjustments to transitional factors for calculating provisional tax for the 2010–11 or later income years

Method	Years			
	2010–11	2011–12	2012–13	2013–14
Standard method adjustment				
110% payment decreases to:	95%	95%	100%	
105% payment decreases to:	95%	95%		
GST ratio method adjustment				
Two years before preceding year RIT decreases to:	80%	80%	85%	90%
Year before preceding year RIT decreases to:	85%	85%	90%	
Preceding year's RIT decreases to:	90%	90%		

For the 2010–11 income year the adjustments apply to provisional tax payments made on or after 1 October 2010.

Consequently, the formulas referred to in sections RZ 5B and RZ 5C from the 2008 Budget measures have been repealed.

New FBT rates (sections RD 50 to 53, RD 58 to 61, and schedule 1, part C, table 1 of the Income Tax Act 2007)

Changes to sections RD 50 to 53 and schedule 1, part C, table 1 of the Income Tax Act 2007 provide for new fringe benefit tax (FBT) rates and thresholds for fringe benefits. These reflect the new personal tax rates. The changes apply to the 2010–11 income year and subsequent income years. For the 2010–11 income year, composite rates apply for attribution purposes to reflect the two sets of rates being used for that year.

FBT rates and thresholds for attribution purposes

Income range	Tax rate
FBT rates for the 2010–11 income year	
$0–$12,390	0.1299
$12,391–$39,845	0.2384
$39,846–$54,915	0.4599
$54,916 and over	0.5504
FBT rates for the 2011–12 and subsequent income years	
$0–$12,530	0.1173
$12,531–$40,580	0.2121
$40,581–$55,980	0.4286
$55,981 and over	0.4925

Employers still have the option of paying FBT at a single rate if they prefer. Changes to sections RD 58 to 61 reduce the single rate from 61% to 49.25%. For close companies and small businesses that are able to file FBT returns annually, the applicable rate is also reduced to 49.25% from the 2011–12 income year. For the 2010–11 income year, however, a composite rate of 55.04% will apply.

New employer superannuation contribution tax rates (schedule 1, part D, table 1 of the Income Tax Act 2007)

Contributions that an employer makes to an employee's superannuation scheme are generally taxed at the employee's marginal tax rate under the employer superannuation contribution tax (ESCT) rules. Schedule 1, part D, table 1 of the Income Tax Act 2007 provides for new ESCT rates. The 12.5% rate drops to 10.5% and the 21% rate drops to 17.5%. The rate reduces from 33% to 30% for people who earn between $57,601 and $84,000.

The changes apply from the first pay period that ends on or after 1 October 2010.

ESCT rates

Income range	Tax rate
$0–$16,800	0.105
$16,801–$57,600	0.175
$57,601–$84,000	0.300
$84,001 and over	0.330

It should be noted that the income ranges at which the ESCT rates apply are higher than the income ranges that apply for personal tax rates. This is to reduce the risk that employer contributions made to employees whose income is close to a threshold are not overtaxed.

New retirement superannuation contribution tax rates (schedule 1, part D, table 5 and schedule 6, table 2 of the Income Tax Act 2007; section 28C of the Tax Administration Act 1994)

Certain entities make contributions to a superannuation scheme for the benefit of their individual members under the retirement superannuation contribution tax (RSCT) rules. These contributions are generally taxed at the member's marginal rate. Schedule 1, part D, table 5 and schedule 6, table 2 of the Income Tax Act 2007 provide for new RSCT rates that reflect the new personal tax rates.

A consequential change has also been made to section 28C of the Tax Administration Act 1994, which deals with notification of a person's retirement scheme prescribed rate, to reflect the new top tax rate.

The changes apply from 1 October 2010.

ACC attendant carers (schedule 4, part I of the Income Tax Act 2007; section 33C(c) of the Tax Administration Act 1994)

Payments to ACC attendant carers are currently subject to a withholding tax rate of 12.5%, which reflects the lowest tax rate. Schedule 4, part I, clause 1 reduces the withholding tax rate to 10.5% from 1 October 2010. A consequential change has also been made to section 33C(c) of the Tax Administration Act 1994. This ensures that these taxpayers do not need to file a tax return if they used either the 10.5% or the 12.5% rate in the 2010–11 income year.

Payments from Māori authorities to members who have not provided a tax file number (schedule 1, part D, table 4 of the Income Tax Act 2007)

The current rate of tax for Māori authority distributions to members who have not provided a tax file number is 38% in schedule 1, part D, table 4, row 2. This rate has been reduced to 33% to reflect the reduction in the top personal tax rate.

The changes apply for payments made on or after 1 October 2010.

Fund withdrawal tax (section CS 1)

Fund withdrawal tax (FWT) is a 4.2% tax payable on some superannuation fund withdrawals for members whose income is above $70,000. FWT was introduced to ensure that taxpayers who are on the highest tax rate (which is generally 38% until 1 October 2010) were not undertaxed under the employer contribution superannuation tax (ESCT) rules, as the top rate for ESCT was 33%.

As a consequence of the new legislation's alignment of the top ESCT rate and the top personal tax rate, fund withdrawal tax was to be phased out so that it would not apply to contributions made after 1 October 2010.

However, officials have instead recommended that fund withdrawal tax be repealed on all withdrawals from 1 April 2011, which is the date from which there is no discrepancy between the top ESCT rate and the top actual tax rate. This will be included in a future bill.

Child taxpayer credit (section LC 3 of the Income Tax Act 2007)

The child taxpayer credit provides children with a tax rebate on income that is not from interest or dividends. This allows an eligible child to earn income (less interest and dividends) up to $2,340 a year tax-free.

As a result of the reduction in the lowest tax rate from 12.5% to 10.5%, section LC 3 of the Income Tax Act 2007 has been consequentially amended so that the current tax-free threshold stays at the same level.

The changes apply to the 2010–11 and later income years.

Transitional circumstances credit (section LC 4 of the Income Tax Act 2007)

The transitional circumstances credit effectively provides a tax-free threshold of $5,824. It is available for some people who earn under $9,880. As a result of the reduction in the lowest tax rate from 12.5% to 10.5%, section LC 4 of the Income Tax Act 2007 has been consequentially amended so that the current tax-free threshold stays at the same level.

The changes apply to the 2010–11 and later income years.

Redundancy tax credit (section ML 2(1) of the Income Tax Act 2007)

Section ML 2(1) has been amended to remove the redundancy tax credit from 1 October 2010. The redundancy tax credit was originally introduced to ensure that the receipt of a redundancy payment did not cause a person to move up a tax threshold and be taxed at a significantly higher tax rate than they would ordinarily. (The top personal tax rate at the time was 39%, which was 6% higher than the next highest personal tax rate at the time. The 39% rate has since been reduced to 38%.) Because the 38% rate is reduced to 33% from 1 October, and because there is a smaller gap between the new 33% top personal tax rate and the next lowest rate of 30%, this credit is repealed from 1 October 2009.

NEW TAX RATES FOR COMPANIES AND SAVINGS

Sections CS 1, FE 5, FE 6, FE 12, FE 18, HM 47, HM 58, HM 60, LP 2, OZ 7 to OZ 17, RZ 3 to RZ 5 and schedules 1 and 6 of the Income Tax Act 2007 and section 140C of the Tax Administration Act 1994

The Taxation (Budget Measures) Act 2010 introduced changes to the tax rules for business and investments.

- The company tax rate is being reduced from 30% to 28%.
- The top tax rate for people saving through portfolio investment entities (PIEs)—including KiwiSaver funds—and other managed funds will also be reduced from 30% to 28%.
- Other tax rates that apply to KiwiSaver funds and other PIEs are being reduced in line with the changes to personal income tax rates.
- The safe harbour in the thin capitalisation rules that apply to foreign-controlled entities is being reduced from 75% to 60%.

Together, these reforms are intended to improve the competitiveness of New Zealand's company tax system and to encourage saving. The changes to the thin capitalisation rules support this objective by ensuring that tax rates apply effectively to foreign-controlled entities.

Key features

The company tax rate will be reduced from 30% to 28%. This change also applies to unit trusts, which are taxed as companies. The resident withholding tax rules for interest paid to companies are being amended accordingly.

The top rate for people saving through PIEs and other managed funds will also be reduced from 30% to 28%. The other tax rates that apply to multi-rate PIEs will be reduced in line with changes to personal income tax rates. Tax rates for investors in multi-rate PIEs will shift automatically from the old rates to the new rates when the changes take effect on 1 October 2010. The rates of retirement scheme contributions tax will be reduced in line with the changes to personal income tax rates.

The thin capitalisation rules deny interest deductions to the extent that the debt percentage (essentially, the debt-to-asset ratio) of a person's New Zealand group exceeds a specified "safe harbour" threshold and is also more than 110 percent of the debt percentage of that person's worldwide group. The safe harbour applying to foreign-controlled entities will be reduced from 75% to 60%. This will reduce the scope for foreign multinational enterprises to reduce the amount of New Zealand tax they pay by loading debt against their New Zealand operations.

A number of transitional arrangements accompany the reduction in the company tax rate. These are based on similar arrangements that accompanied the previous reduction in the company tax rate to 30%. The transitional rules:

- allow companies to continue to pay out imputation credits at the current 30/70 credit-to-dividend ratio until 31 March 2013, provided the credits arose when the company tax rate was 30% or 33%;
- allow shareholders—other than those eligible for the new 28% tax rate—to use these additional imputation credits to offset their tax; and
- allow companies that pay provisional tax using the uplift method or the GST ratio method to have immediate access to the tax cut.

Application dates

For investments through multi-rate PIEs, including most KiwiSaver funds, the reduced tax rates—including the new 28% top rate—will apply from 1 October 2010.

For companies, and for investments through other managed funds, the reduction in the tax rate to 28% will apply for the 2011–12 and subsequent income years. The changes to the thin capitalisation rules will also apply for the 2011–12 and subsequent income years.

Detailed analysis

Unless otherwise stated, the following references to sections and schedules relate to the Income Tax Act 2007.

Tax rates

The reduction in the company tax rate and changes to the tax rates that apply to investments through PIEs and other managed funds are achieved through amendments to a number of provisions.

Clause 2 of schedule 1, part A has been amended to reduce the company tax rate to 28%. Since the definition of "company" in section YA 1 includes unit trusts, this reduction also applies to unit trusts. The lower company tax rate will automatically affect the maximum imputation and FDP crediting ratio under section OA 18, which will change from 30/70 to 28/72. A consequential amendment has been made to the formula in section LP 2(2) for calculating tax credits for supplementary dividends.

Clauses 5 and 6 of schedule 1, part A have been amended to similarly reduce the tax rate for group investment funds deriving category A income, approved unit trusts to which the Income Tax (Exempt Unit Trusts) Order 1990

applies, widely held group investment funds, and widely held superannuation funds. Clause 8 of schedule 1, part A has been amended to reduce the rate for life insurance policyholder income.

In schedule 1, part D, table 3, rows 1 and 2 are amended to reduce the rate of resident withholding tax applicable to interest paid to companies when the payer of the interest has been supplied with the tax file number of the company and has either not received a payment rate election or has received a payment rate election choosing the 28% payment rate. Rows 3 and 4 have been amended in line with the changes to personal income tax rates, reducing the rate of resident withholding tax from 38% to 33% for interest paid to a company when the recipient of the interest has either elected for the top personal rate to apply or has not supplied their tax file number to the interest payer.

Changes to the prescribed rates for multi-rate PIEs are contained in schedule 6, table 1.

Section HM 58, as amended, operates to adjust automatically notified investor rates for multi-rate PIEs, unless the investor advises the PIE that a different rate should apply. Section HM 60(6) has been amended so that, if an investor does not notify a multi-rate PIE of their notified investor rate, the rate applied will be 28%.

Section HM 60(3) has been replaced by a new subsection (3) so that multi-rate PIEs can calculate tax for the 2010–11 income year using current notified investor rates for each day in the year up to and including 30 September and the new lower rates for remaining days in the income year. The new lower rates that the multi-rate PIE will apply from 1 October is the rate automatically adjusted on that date under the revised section HM 58 or another rate notified by the investor on or after that date. Consequential amendments to the PIE multi-rate calculation provisions in section HM 47(4)(a)(i) support this treatment.

Section HM 47(4)(ii) has been amended so that, if the PIE is treated as the sole investor, the rate applied will be 28%.

Retirement scheme contributions tax has been reduced by amendments to schedule 6, table 2.

Note that section CS 1, which deals with fund withdrawal tax on superannuation funds, is amended as a consequence of the alignment of the top rate of employer superannuation contribution tax with a taxpayer's marginal rate. This is discussed further in the TIB item that deals with the changes to personal income tax rates.

Provisional tax rules for companies

Provisional tax involves payments being made during an income year, in anticipation of an income tax liability for that year. Section RC 5 sets out various methods of calculating provisional tax.

The "standard method" of determining provisional tax liability, under section RC 5(2) and (3), looks to a person's residual income tax for a previous year, uplifting that amount by a specified percentage—normally either 5% or 10%, depending on the circumstances. In view of the reduction in the company tax rate, section RZ 3 has been amended to reduce temporarily the amount of that uplift for persons subject to the new company tax rate of 28%.

- Where the 5% uplift method applies, section RZ 3(1)(b) and (2)(b)(ii) modifies section RC 5(2) to eliminate any uplift for the 2011–12 income year.
- Where the 10% uplift method applies, section RZ 3(1)(b), (3)(b)(ii) and (c)(ii) modifies section RC 5(3) to reduce the amount of the uplift to 5% for the 2011–12 and 2012–13 income years (in this case, the modification applies for two years, because section RC 5(3) looks to a person's residual income tax for the tax year before the preceding tax year).

Corresponding modifications to section RC 10 have been made by section RZ 5.

Some provisional taxpayers can choose to calculate their provisional tax payments using the "GST ratio method" under section RC 8. The GST ratio is normally calculated by dividing residual income tax for the preceding year by taxable supplies in that year, although in certain circumstances amounts from earlier years may be used instead. Section RZ 4 modifies section RC 8, reducing the income tax amounts used for the purposes of calculating the GST ratio to reflect the reduction in the company tax rate. For the 2011–12 and 2012–13 income years, section RZ 4(1)(b) and (2)(b) provides that the income tax amount for a new company tax rate person is to be multiplied by 0.95.

Thin capitalisation rules for foreign-controlled entities

For a person falling within their ambit, the thin capitalisation rules deny interest deductions to the extent that the debt percentage of that person's New Zealand group exceeds the higher of two thresholds specified in section FE 5. One threshold is a "safe harbour". The other threshold is determined as being 110% of the debt percentage of the person's worldwide group (this threshold does not apply to individuals).

The scope of the thin capitalisation rules was recently extended by the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009. Previously, the rules only applied to New Zealand taxpayers if they were, or were controlled by, a non-resident (section FE 2(1)(a) to

(d)). They now also apply to New Zealand residents with an income interest in a controlled foreign company (CFC) or with control of a resident company with such an interest (section FE 2(1)(e) to (g)).

Section FE 5 has been amended to reduce the safe harbour for taxpayers that are, or are controlled by, a non-resident from 75% to 60%. This lower safe-harbour is set by section FE 5(1)(a)(i) and (3)(a). The safe harbour for New Zealand residents with CFC interests remains at 75% (section FE 5(1)(b)(i) and (3)(b)). The 110% threshold is also unchanged (section FE 5(1)(a)(ii) and (b)(ii)). Consequential amendments have been made to section FE 6(3)(e) and section FE 12(2).

Section FE 18(5) sets the default percentage for the worldwide group of an excess debt entity. Currently, the default percentage is 68.1818, an amount that when multiplied by 110% is equivalent to a 75% safe harbour. This section has been amended so that, for taxpayers subject to the reduced safe harbour, the default percentage becomes 54.5454: multiplied by 110%. This matches a 60% safe harbour.

The special thin capitalisation rules for banks are not affected by these changes.

Company tax: Transitional arrangements

Imputation and fair dividend payment crediting ratios

An immediate reduction of the crediting ratio allowed under section OA 18, which caps the ratio of imputation or fair dividend payment (FDP) credits to dividends, has the potential to disadvantage shareholders if the dividends to which it applies represent a distribution of income that was taxed at 30%. Therefore, the legislation allows this maximum ratio to be overridden for dividends paid during a transitional period, beginning on the first day of the company's 2011–12 income year and ending on 31 March 2013. During that period, companies can attach imputation and FDP credits to dividends up to a maximum ratio of 30/70, provided the underlying income was taxed at 30%. This is achieved by updating sections OZ 7 and OZ 8, which were introduced to deal with the previous company tax rate cut.

If a company imputes dividends using a 30/70 ratio after the 2010–11 income year to an extent that exceeds the credit balance in its imputation credit account relating to income taxed at 30%, a 10% transitional imputation penalty tax will apply under section 140C of the Tax Administration Act 1994. Penalty tax will only arise under section 140C if there is a debit balance relating to 30/70 credits on 31 March 2013. If penalty tax is also payable under section 140B because of an overdrawn balance at 31 March 2013, it will be reduced by any amount payable under section 140C.

Benchmark dividends

Sections OB 61 and OC 28 provide that the amount of imputation or FDP credits attached to the first dividend paid by a company in a tax year (the "benchmark dividend") sets the imputation ratio for that year. The imputation ratio of subsequent dividends paid in the year must be the same as for the benchmark dividend, unless the company makes a ratio change declaration.

Section OZ 9 has been updated to modify the benchmark dividend ratios in sections OB 61(4) and OC 28(4). This allows companies to change their crediting ratio from 30/70 to 28/72 without making a ratio change declaration. If the benchmark dividend was paid before the start of the 2011–12 income year and credited using a 30/70 ratio, section OZ 9 allows subsequent dividends paid during the transitional period to be credited using a 28/72 ratio. In addition, if the benchmark dividend was credited using a 30/70 ratio under section OZ 8, section OZ 9 allows a 28/72 ratio to be used for subsequent dividends once credits accrued under the 30% tax rate have run out.

Shareholders' tax credits

If the amount of imputation credits or FDP credits exceeds the maximum ratio allowed under section OA 18, the tax credit available to the shareholder is normally limited to that maximum. Section OZ 10 has been updated to modify sections LE 8 and LE 9 and sections LF 6 and LF 7, allowing shareholders to benefit from additional credits during the transitional period, when these have been attached to dividends in accordance with section OZ 8.

However, if the shareholder is a person, including a multi-rate PIE, eligible for the new 28% rate, section OZ 11 limits the credit available against their tax liability based on a 28/72 ratio, even if the actual crediting ratio of the dividend was higher than this by virtue of section OZ 8. Since a new company tax rate person will only be subject to 28% tax on the dividend, it would be inappropriate to allow them to benefit from additional credits, which could be used to offset tax on other income.

Tax credits for non-residents

The formula in section LP 2(2) for calculating tax credits for supplementary dividends is amended, reflecting the new 28/72 crediting ratio. Section OZ 12 has been updated to maintain the existing formula for dividends imputed using a 30/70 ratio under the transitional rules.

Available subscribed capital

The concept of "available subscribed capital" is relevant when a company cancels its shares and pays consideration to compensate a shareholder for that cancellation. For the purposes of determining available subscribed capital, the

extent to which a dividend is fully credited may be relevant. The extent to which a dividend is treated as credited is determined using the formula in section CD 43(26). Section OZ 13 has been updated to provide that a ratio of 28/72 should be used for the purposes of this formula even if a dividend has an imputation ratio up to 30/70 during the transitional period.

Dividends from qualifying companies

A dividend paid by a qualifying company is only taxable in the hands of the shareholder to the extent it is imputed: these dividends are therefore required to be imputed to the maximum extent possible under the imputation rules given the company's available credits. The formula for calculating the amount of a fully imputed distribution is set out in section HA 15(2). Section OZ 14 has been updated to modify this formula, to treat the tax rate as 30%, rather than 28%, for dividends paid during the transitional period to which section OZ 8 applies.

Statutory producer boards and cooperative companies

For a statutory producer board, the allocation of credits to cash distributions must be done according to the formula in section OB 73(4), while section OB 75(2) allocates credits to notional distributions. For cooperative companies, the equivalent provisions are sections OB 78(3) and OB 80(2). Section OZ 15 has been updated to allow these entities to use a 30/70 crediting ratio during the transitional period.

Branch equivalent tax accounts and conduit tax relief accounts

Sections OZ 16 and OZ 17 have been updated so that entries in the branch equivalent tax accounts or conduit tax relief accounts of companies or consolidated groups that relate to 2010–11 or earlier income years are adjusted in line with the proposed reduction in the company tax rate. This is because credit balances in these accounts will be used to offset tax liabilities calculated under the proposed new company tax rate.

CHANGES TO BUILDING DEPRECIATION

Sections EE 31, EE 35(2), EE 48(1), EE 61, EE 64(2), EE 37, EZ 13(2), EZ 14(1) and schedule 39 of the Income Tax Act 2007

Budget 2010 introduced changes to the depreciation rate of buildings. The changes were intended to make New Zealand's tax rules more neutral by recognising that allowing depreciation on long-lived buildings and the application of depreciation loading on certain assets provides tax depreciation rates in excess of true economic deprecation rates.

The depreciation rate of buildings with long estimated useful lives has been changed to 0%. This new rate applies to all such buildings regardless of when they were purchased. This change is intended to make New Zealand's tax rules more neutral and non-distortionary.

Background

Buildings with an estimated useful life of 50 years have been able to be depreciated for tax purposes at a rate of 2% per annum. However, analysis of New Zealand building price data between 1993 and 2009 shows that, on average, buildings have actually been increasing in value. This suggests that the 2% depreciation rate is not appropriate.

Key features

- The annual depreciation rate for buildings has been set to 0% if they have estimated useful lives of 50 years or more, as determined by the Commissioner of Inland Revenue.
- The annual depreciation rate has also been set to 0% for certain buildings that are excluded depreciable property and that are similar to the types of buildings with estimated useful lives of 50 years, as these do not have estimated useful lives.
- This new rate applies regardless of when a building was acquired.
- Building owners that have previously claimed a depreciation deduction on their buildings are still required to pay depreciation recovery if they sell a building for more than its tax book value.
- To ensure that the policy works as intended, special depreciation rates are no longer allowed for buildings. The definition of "temporary building" has also been amended.

Detailed analysis

Annual rate for buildings with long estimated useful lives

Sections EE 31, EZ 13 and EZ 14 have been amended to provide that buildings with an estimated useful life of 50 years or more will have an annual depreciation rate of 0% for tax purposes. This 0% rate is a statutory rate and overrides the rates set by determination issued by the Commissioner of Inland Revenue.

The changes to section EE 31 apply to buildings acquired during or after the 1995–96 income year, while the changes to section EZ 13 and EZ 14 apply to buildings acquired after 1 April 1993 but before the end of the 1994–95 income year.

These buildings are still depreciable property, but have a 0% annual depreciation rate. This means that the other depreciation provisions, such as those providing for depreciation recovery, still apply.

While the depreciation rate for these buildings is 0%, the depreciation rate for items used in, but not part of, these buildings remains unchanged, and they can continue to be depreciated separately from the building itself.

For residential rental properties, the interpretation statement, *Residential rental properties – depreciation of depreciable assets* (IS 10/01), sets out how to determine whether an item is part of a building or separately depreciable.

For non-residential properties, the Government has indicated that it will be reviewing which items can be depreciated separately from a building. If necessary, the tax rules will be amended before 1 April 2011 to clarify the law on this point.

Repairs and maintenance

These changes do not affect the deductibility of repairs and maintenance. While this can be a complicated matter, with the correct treatment often being a question of both fact and degree, some general guidance is set out below.

There is a two-stage approach to determine whether certain expenditure is deductible:

1. Identify the relevant asset—that is, is the item being repaired/replaced part of a larger asset (such as the roof of a house), or is it a single asset (for example, a television).
2. Ascertain the nature, extent and cost of the work undertaken. This will involve determining whether the work remedied wear and tear (generally deductible), or whether the asset has been improved or otherwise substantially changed (generally non-deductible).

In relation to step 2, some relevant factors are:

- If the expenditure does no more than restore an asset to its condition on purchase, it is likely to be deductible.

This can hold even if the work is carried out over several years.

- This applies even if what is being replaced or repaired is improved, for example, because of new technology or better design, provided the work does not alter a substantial part of the asset.
- Expenditure on the renewal, replacement or reconstruction of a substantial portion of the asset goes beyond repair, and is generally not deductible repairs and maintenance.
- Work that results in a significant increase in an asset's value, or is unusually expensive, is more likely to be considered capital in nature.

As discussed above, a building can have many different parts. Repairing or replacing something that forms part of a building, provided it does not substantially improve or alter the value or function of the building, is likely to be deductible. If, on the other hand, a substantial amount of work is involved, or the building is improved in some way, it is likely that this will be non-deductible capital expenditure. For example, the replacement of a toilet that has fallen into disrepair in a residential house (which is part of the building as per IS 10/01) is likely to be deductible as repairs and maintenance. On the other hand, if the entire bathroom were to be re-designed and completely re-fitted, this is more likely to be a non-deductible capital improvement.

Definition of "building"

These amendments only affect the depreciation rate of buildings—there are no changes to the depreciation rates for structures. What a "building" is, for the purposes of the depreciation provisions, therefore becomes important. The Commissioner of Inland Revenue's view on this is set out in the recently released interpretation statement *Meaning of "building" in the depreciation provisions* (IS 10/02).

In essence, a building is a structure that has walls and a roof, is of considerable size, is meant to last a considerable period of time and is generally fixed to the land where it stands. For example, a house has the above features and so would be considered a building. However, a dam does not (it lacks walls and a roof), so would not be considered a building.

For more guidance on this issue, the interpretation statement IS 10/02 is available on Inland Revenue's website, **www.ird.govt.nz**.

Interpretation of "estimated useful life"

An item's estimated useful life is the estimated useful life for that type of item, as set out in a determination issued by the Commissioner of Inland Revenue. Additionally, when interpreting an item's estimated useful life, the "whole of life" approach should be taken. For example, if a person purchases a second-hand item with an estimated useful life of 50 years, its estimated useful life will still be 50 years, regardless of how old the item actually is.

No special rate for buildings

Amendments to section EE 35(2) mean that special depreciation rates can no longer be set for buildings, regardless of their estimated useful lives. Special depreciation rates are granted in situations where a specific item's economic depreciation rate is either faster or slower than the rate set by the Commissioner of Inland Revenue. This change has effect from 20 May 2010.

The ability to apply for special rates for buildings is being removed as allowing these is inconsistent with the general view that buildings, do not on average, decline in value.

However, provisional depreciation rates can still be set for classes of buildings. If the Commissioner of Inland Revenue issues a provisional rate for a class of building stating that it has an estimated useful life of less than 50 years, owners of affected buildings will be able to claim depreciation deductions.

Provisional depreciation rates are granted when there is no applicable rate for the type of item owned, excluding the default class. To have a provisional rate granted, an owner must satisfy the Commissioner that the building does not come within an existing asset category.

Applications for provisional rates can be made using the form IR 260A, available from Inland Revenue's website at **www.ird.govt.nz**.

Special excluded depreciable property

Section EE 67 has been amended to provide a definition for "special excluded depreciable property". Special excluded depreciable property means all buildings not listed in new schedule 39.

In practice, special excluded depreciable property means buildings that were excluded depreciable property, and are similar to the current categories of building that have estimated useful lives of 50 years or more.

The asset classes listed in this schedule are from the depreciation rates issued by the Commissioner of Inland Revenue before 1 April 1993. In some cases, the names of these classes differ from those currently used in the depreciation determinations.

This definition of "special excluded depreciable property" is necessary because items of excluded depreciable property do not have estimated useful lives. It is therefore not possible to refer to these buildings using "estimated useful lives".

0% annual depreciation rate for special excluded depreciable property

Section EE 61 has been amended with new subsection 7B. This subsection provides that the annual depreciation rate for items of special excluded depreciable property that are excluded depreciable property is 0%.

This statutory rate overrides any depreciation rate issued by the Commissioner of Inland Revenue.

Buildings that are excluded depreciable property but not special excluded depreciable property will continue to be depreciated using the appropriate depreciation rates.

Change to the meaning of "temporary building"

Paragraph (a) in the definition of "temporary building" in section YA 1 has been repealed. This paragraph provided that a "temporary building" includes buildings issued under a permit by a local or public authority that stipulates that the building be removed or demolished at their request.

This change ensures that the proposed changes work as intended, as otherwise building owners could claim that their building was a temporary building under this paragraph of the definition.

Example

Jack owns two buildings that he is currently allowed to claim depreciation deductions for. One building is a residential rental house and the other is a glasshouse.

For the 2010–11 income year, the applicable depreciation rates are 2% straight-line for the rental house and 5% straight-line for the glasshouse. This means Jack can claim depreciation deductions of 2% and 5% of the respective building's cost.

Depreciation determination DEP1 provides that the rental house currently has a useful life of 50 years and that the glasshouse has a useful life of 20 years. Therefore, for the 2011–12 income year, the applicable depreciation rates are 0% for the rental house and 5% straight-line for the glasshouse. This means Jack cannot claim depreciation deductions for his rental house, but can continue to claim them for the glasshouse at a rate of 5%.

Application dates

The amendments largely apply from the beginning of the 2011–12 income year. For most people this is 1 April 2011, but if taxpayers have had a different income year approved by the Commissioner of Inland Revenue, they would apply from that date. For taxpayers with an early balance date, this may be as soon as 2 October 2010.

Provisional depreciation rates for categories of buildings

Question

We have been asked to clarify what buildings we consider will be able to be the subject of an application for a provisional depreciation rate.

Answer

A taxpayer will be able to apply for a provisional depreciation rate for a class of building if the class of building is sufficiently different from the existing building classes in the Commissioner's table of depreciation rates so that the existing depreciation rates or building class descriptions do not seem accurate for the particular class of building under consideration.

Discussion

From 1 April 2011, the economic rate for buildings with an estimated useful life of 50 years or more is 0%. However, provisional depreciation rates will still be able to be set for classes of buildings. If the Commissioner issues a provisional rate for a class of building stating that it has an estimated useful life of less than 50 years, owners of affected buildings will be able to claim depreciation deductions.

A person may apply for a provisional depreciation rate for an item when there is no applicable economic rate for the item (other than a default rate) in the Commissioner's table of depreciation rates: section 91AAG(1)(b) of the Tax Administration Act 1994. The Commissioner may decline to issue a provisional rate if there is an applicable economic rate for the item (other than a default rate) in the Commissioner's table of depreciation rates: section 91AAH(3)(a) of the Tax Administration Act 1994.

The Commissioner's table of depreciation rates includes economic rates for several classes of buildings based on the materials used in their construction. Examples of this are the asset classes "buildings with timber framing" and "buildings with reinforced concrete framing". To have a provisional rate granted, the building owner must satisfy the Commissioner that the class of building does not fall within one of the existing building asset classes. This will be based on the characteristics of the class of building itself, not the way that a particular building is used.

Example 1

A purpose-built building has features that mean that none of the existing asset classes such as "building with reinforced concrete framing" apply to the building. These features may include a mixture of structural framing, including insulation panels for parts of the building requiring specialised temperature-controlled conditions and the use of other specialised building components. These features may mean the building has an estimated useful life of less than 50 years. In this case, a taxpayer may apply to the Commissioner for a provisional rate for the building.

Example 2

A house used as a doctor's surgery, where the alterations do not fundamentally change the nature of the building in such a way as to affect its estimated useful life, would not meet the threshold for a provisional depreciation rate. In this case, a taxpayer would not receive a provisional rate for the doctor's surgery.

How to apply for a provisional rate

Applications for provisional rates can be made using the form IR 260A, available from Inland Revenue's website at **www.ird.govt.nz**.

If a provisional rate is issued it may apply to all taxpayers, to a group of specified taxpayers, or to a specific taxpayer

CHANGES TO DEPRECIATION LOADING

Sections EE 31, EE 37 and EE 61 of the Income Tax Act 2007

Depreciation loading increases the tax depreciation rate by 20% for qualifying items. It was introduced as an incentive to encourage New Zealand businesses to invest in new capital equipment. However, this concession is inconsistent with a broad-based, low-rate tax system, and so it has been removed from items purchased after 20 May 2010.

Key features

- Depreciation loading has been removed from assets purchased after 20 May 2010.
- Depreciation loading continues to apply to qualifying assets purchased on or before 20 May 2010.
- Any improvements to assets that continue to receive loading made after 20 May 2010 must be treated as a separate asset and do not qualify for loading.

Detailed analysis

No depreciation loading for items purchased after 20 May 2010

Section EE 31 has been amended with new subsection (3). This subsection applies when a binding contract for an asset's acquisition or construction is entered into after 20 May 2010. It provides that an asset's annual depreciation rate is just its applicable economic, special or provisional rate, unless the item is a long-lived building or international aircraft.

This contrasts with existing subsection (2), which applies to assets for which a binding contract for acquisition existed on or before 20 May 2010. Under this section, many assets have an annual rate of their applicable economic, special or provisional depreciation rates multiplied by 1.2. This acceleration of depreciation rates is often referred to as depreciation "loading".

Treatment of improvements

Amendments to section EE 37 apply if a person owns an asset that will continue to receive loading after 20 May 2010. It provides that if they make improvements to the asset, or enter into a binding contract to make improvements to an asset, they must treat the improvements as separate items. Therefore, the annual depreciation rate for these improvements is set by new subsection EE 31(3) (Rate for item acquired after 20 May 2010).

The effect of this is that any improvements made to assets purchased before 20 May 2010 will be ineligible for depreciation loading. These improvements will depreciate for tax purposes at the appropriate rate as set by the Commissioner of Inland Revenue.

Example

On 1 April 2010, A Co Ltd purchased $10,000 worth of laptop computers. Laptop computers have a 40% straight-line depreciation rate, but as they are eligible for loading, A Co Ltd is able to claim depreciation deductions of 48% of their value, or $4,800 each year.

On 1 April 2011, A Co Ltd purchased another order of $10,000 worth of laptop computers. However, as they have been purchased after 20 May 2010, A Co Ltd is only able to claim depreciation deductions of 40% of their value, or $4,000 each year.

This means, for the 2011–12 income year, A Co Ltd can deduct $4,800 for depreciation of the earlier laptops and $4,000 for the later laptops.

Application date

The new rules for depreciation loading came into force on 20 May 2010. They apply to all new items of depreciable property for which a binding contract for acquisition or construction was entered into after 20 May 2010.

GRANDPARENTING CERTAIN BUILDINGS AS STRUCTURES

Sections EE 37 and YA 1 of the Income Tax Act 2007

Inland Revenue's Public Rulings unit has recently released the interpretation statement *Meaning of "building" in the depreciation provisions* (IS 10/02). Under this statement, some items that were previously treated as structures will come within the meaning of "building". This means there will be a change to the way these investments are treated for tax depreciation purposes.

On 30 July 2009, following the release of a draft of this interpretation statement, the Minister of Revenue issued a statement providing that the existing treatment of any affected structure acquired on or before the day of the announcement would be grandparented. Accordingly, section YA 1 has been amended to include a definition for "building". This definition specifies that a building does not include these affected structures.

Key features

- Certain buildings that have been treated as structures and were purchased on or before 30 July 2009 will continue to be treated as structures for tax depreciation purposes.
- Any improvements to these buildings made after 30 July 2009 do not receive this grandparented treatment.

Detailed analysis

Certain structures purchased on or before 30 July 2009 are not "buildings"

Amendments to section YA 1 have introduced a definition for buildings, which specify that, in the depreciation provisions, "building" does not include a grandparented structure. This definition of "building" excludes "grandparented structures" from the common law meaning of "building". This definition is not intended to detract from the Commissioner's interpretation statement IS 10/02 *Meaning of "building"*. Instead, the definition is intended to grandparent investments, made before 30 July 2009, in certain types of structures from the depreciation rules applying to buildings.

This means that these buildings will continue to be treated as structures for the purposes of the depreciation provisions (notwithstanding that they are buildings under the Commissioner's interpretation statement IS 10/02). For example, their relevant depreciation rates will still be set using the double-declining balance method, and losses incurred on disposal will remain tax deductible. If a grandparented structure is sold after 30 July 2009, it will lose its grandparented treatment and will be treated as a building.

The definition of "grandparented structure" is an item on the following list, provided its owner acquired it, or entered into a binding contract for its acquisition or construction, on or before 30 July 2009:

(a) barns, including barns (drying)

(b) carparks (buildings)

(c) chemical works

(d) fertiliser works

(e) powder drying buildings

(f) site huts.

More detail on the types of items covered by the definition of "grandparented structure" can be found in IS 10/02, available on Inland Revenue's website. For example, carparks (buildings) does not include a commercial building that contains carparks.

Some carparking buildings continue to depreciate

The grandparenting of carparking buildings, described above, means that carparking buildings purchased on or before 30 July 2009 are not subject to a 0% annual depreciation rate.

Improvements to grandparented structures building

Section EE 37 has been amended to provide that if a person owns a grandparented structure and they make improvements or enter into a binding contract to make them after 30 July 2009, the improvement must be treated as a separate item.

The effect of this amendment is that any new improvements to grandparented structures will be treated as buildings. This means, for example, losses on disposal of the improvements will not be available. In the case of carparking buildings, this means the annual depreciation rate of any improvements will be 0%.

Application date

The amendments apply from 30 July 2009.

NEW TREATMENT OF CAPITAL CONTRIBUTIONS

Sections CG 8, DB 64, EE 48 and YA 1 of the Income Tax Act 2007

A capital contribution is a subsidy or similar payment to a person that compensates them for some capital expenditure. A common example is a payment from a farmer to an electricity lines company towards the cost of connecting their farmhouse to the company's network.

Amendments have been made to the Income Tax Act 2007 so that recipients of capital contributions will have to choose either to treat the contribution as income spread over 10 years, or alternatively, reduce the tax book value of the subsidised assets.

Background

Previously, capital contributions were generally not taxable in the hands of the recipient as they are of a capital nature. In addition, the recipient may have been able to deduct, by way of depreciation, the cost of the assets acquired with the capital contribution. This meant that it was possible for the recipient to claim deductions for expenditure that had been funded through untaxed receipts.

Key features

- Businesses that now receive a capital contribution must choose, for income tax purposes, to treat the receipt as income or as a reduction in their depreciation base. Different treatments can be elected for each capital contribution but once an election is made it may not be changed.
- If a business decides to treat a contribution as income, it must return 1/10th of the contribution as taxable income every year for 10 years.
- If a business decides to reduce its depreciation base, it must reduce the tax book value of the relevant assets to the extent that they have been funded through the capital contribution.

Detailed analysis

Capital contributions either income or non-deductible

The definition of "capital contribution" in section YA 1 has been amended. Outside of section HG 11, a capital contribution now means an amount that:

(i) is paid to a person (the payer) by a person (the recipient) under an agreement between them that is not a contract of insurance;

(ii) is paid by the payer other than in their capacity of settler, partner or shareholder of the recipient;

(iii) is not income of the recipient, ignoring section CG 8;

(iv) is paid, under the express terms and conditions of the agreement, as a contribution for depreciable property owned or to be acquired by the recipient.

Part (i) of this definition ensures that insurance pay-outs to cover the replacement of damaged assets do not fall within this definition, as they are not capital contributions. Part (ii) ensures that payments by settlers, partners or shareholders who are introducing capital into their own businesses in their capacity as owners are not included.

New section CG 8 provides that a capital contribution that a person receives is treated as income in the income year it is received and the nine following income years. The formula for calculating the amount that is income in each income year is set out in section CG 8(2). This is simply the amount of the contribution divided by 10.

Section CG 8 provides the default treatment. However, if a person elects, they can instead use the treatment in section DB 64. This election is provided because it was recognised that some businesses would have difficultly implementing section DB 64.

Section DB 64 applies when a person derives a capital contribution and would be allowed an amount of depreciation loss for the acquired assets. Subsection (2) provides that the amount of the capital contribution would be excluded from the item's adjusted tax value, base value, cost, or value, as applicable, for the purposes of part EE (Depreciation). Essentially, this means the recipient would not be able to claim depreciation deductions to the extent that any acquired assets have been paid for by capital contributions.

Any election must be made in the recipient's tax return for the income year in which the relevant capital contribution is derived. Each new capital contribution would require a new election, and the recipient can elect to treat different contributions differently. Once an election has been made in respect of a contribution, it is unchangeable.

Effect on disposal

Section EE 48 has been amended so that, if a person has elected to apply section DB 64, the amount of the capital contribution is added to the calculation of subsection (1)(b) for the purposes of calculating depreciation recovery income.

Example: Capital contributions

Under the old rules

Ben's Electricity Company is an electricity lines company. On 1 June 2009, a farmer requested that his farmhouse be connected to Ben's Electricity network. As the work, costing $10,000, would otherwise be uneconomic, Ben's Electricity required a $6,000 capital contribution from the farmer.

Ben's Electricity Company can claim depreciation deductions on the full $10,000 cost of the connection to the farmhouse. Also, Ben's Electricity Company successfully argues that the capital contribution payment is a capital receipt and, therefore, is not taxable.

Under the new rules

On 1 June 2010, a different farmer requested for his farmhouse to be connected to Ben's Electricity network. The work, again costing $10,000, would have otherwise been uneconomic, so Ben's Electricity again required a $6,000 capital contribution from the farmer.

Election to treat as income

If Ben's Electricity Company elects to treat the capital contribution as income, it will return 1/10th of the $6,000 capital contribution as taxable income for the next 10 years. In other words, it will return $600 extra income in its 2010–11 income year, and continue to do this until its 2019–20 income year.

Election to reduce depreciation base

If Ben's Electricity Company elects to reduce its depreciation base, it will be unable to claim depreciation on the cabling and other assets that make up the new connection to the extent that they were funded by the capital contribution. In other words, it can only claim depreciation deductions on the $4,000 cost for which it bore the financial burden.

Application date

These amendments apply to capital contributions derived after 20 May 2010.

GST RATE INCREASE

Sections 8, 10, 12, 21CB, 21F, 21I(4B), 46, 78 and 78B of the GST Act 1985; sections MD 3, ME 1, MF 4B, MF 4C, MF 4D, MF 4E of the Income Tax Act 2007; sections 13 and 183AA of the Tax Administration Act 1994

The rate of goods and services tax (GST) will increase from 12.5% to 15% from 1 October 2010, as part of a switch in the tax mix from income tax to consumption tax announced in Budget 2010. The GST rate was last increased in 1989.

New Zealand relies heavily on income taxes in order to fund expenditure. Income taxes may, however, be harmful for efficiency and growth. Taxes on consumption, such as GST, tend to be less harmful to growth as, unlike income taxes, they do not apply to savings and, therefore, do not discourage this activity. A switch from income tax towards GST can, therefore, boost incentives to save and encourage economic growth.

The merits of changing the tax mix were discussed in the report of Victoria University of Wellington's Tax Working Group, *A Tax System for New Zealand's Future* released in January this year.

Background

How will it be calculated?

Businesses and organisations registered for GST will be required to account for GST at the new rate of 15% from 1 October 2010. The rate of increase will also apply to goods imported on or after 1 October 2010.

The new tax fraction (the tax rate divided by the sum of 100 plus the tax rate) used to calculate GST will be 3/23. This fraction can be applied to the price of goods or services to see how much GST is included in the price. For example, if the cost of a fridge is $2,000 inclusive of GST, the GST included in the price will be $260.87[1]:

$$\frac{(\$2,000 \times 3)}{23}$$

Altering systems and prices

Businesses will need to alter their systems to incorporate the new rate. They may also need to alter the prices they charge for the goods and services they supply to cover the increased GST liability. This may affect businesses' current stocks and transactions as well as forward orders or deferred supplies.

There are rules within the GST Act to deal with transitional matters arising from a rate change. These rules provide for prices in existing contracts to be increased by the amount of GST in certain circumstances, and fees and other charges set by Act or regulation are automatically increased by the amount of the GST rate increase.

The legislation ensures that government grants and subsidies are not automatically increased when there is a change in the GST rate. Instead, the relevant administering public authorities will be considering the implications for grant recipients on a case-by-case basis over the coming months.

Compensation for price increases

The increase in GST will affect everyone due to a rise in most prices. Statistics New Zealand has estimated that overall prices will increase by about 2.0%. To illustrate this—a $100 item (before GST) will increase in price from $112.50 (current rate of GST) to $115 (the new rate). This is an increase of 2.22%. However, 9% of spending is on items that do not incur GST. When these items are taken into account the overall price impact drops back to 2.02%. Items that are exempt from GST include rent for private premises, mortgage payments, school donations and some credit service charges.

Compensation for price increases has been provided in a range of cases, including in relation to tax credits. Immediate compensation is being provided to people receiving Working for Families tax credits. The Family Tax Credit and the Minimum Family Tax Credit will increase by 2.02% from 1 October 2010. After this increase, the automatic indexation of the Family Tax Credit will continue. That is, if the cumulative increase in the CPI since the last adjustment to the Family Tax Credit (in October 2008) is greater than 5% in December 2010, the credit will be adjusted for the movement in the CPI since that time. However, this adjustment for inflation will exclude the 2.02% increase already provided on 1 October 2010.

Filing returns

As happened in 1989 when GST was last increased, there will be an effect on businesses' return filing. In particular, registered persons will continue to file GST returns at their normal times, but if the return period straddles 1 October 2010 the return will need to be split into two parts—the first covering the period up to 30 September and the second covering the remainder of the return period from 1 October. A special return will be provided for this purpose.

To simplify the accounting for those who return GST on either a payments or hybrid basis, the new 15% rate will apply to all payments made or received from 1 October. An adjustment based on the registered person's creditors and debtors as at 30 September 2010 will ensure that supplies

[1] The tax fraction under a 12.5% GST rate is 1/9, calculated as 12.5/112.5. Under that scenario, the GST is $2,000/9 = $222.22.

provided before 1 October but which have not been paid for by that date will in effect be subject to the old lower rate. A similar adjustment mechanism applied in 1989.

If a taxpayer's GST taxable period spans the GST rate change and the taxpayer is required to make a combined GST and provisional tax payment, the transitional return will provide guidance on how to make the combined payment. Advice will also be provided on how to account for the GST on FBT, entertainment tax and other deemed supplies during the transition.

Time of supply rules

The GST Act contains rules that determine the point in time when a GST-registered person must recognise a supply of goods and services that give rise to an output tax liability. In most cases this will be when the supplier issues an invoice or receives payment. The rules attempt to approximate when a transaction has been concluded and economic control of the goods and services has passed from the supplier to the recipient.[2]

In general, the normal time of supply rules will apply over the transition period. Reliance on the normal time of supply rules may allow businesses to bring forward invoicing so they can take advantage of the old lower GST rate. In excessive cases the general anti-avoidance provision in the GST Act may be applicable if it is clearly evident that businesses are restructuring their business practices to bring forward a material number of transactions.

Communication

Inland Revenue will be providing explanatory material to taxpayers on the changed requirements and transition arrangements. See also **www.ird.govt.nz/budget**.

Legislative changes

Some minor legislative changes have been made to the transitional provisions to remove interpretative ambiguity, to cover deemed supplies and to simplify the Act's return filing and record-keeping requirements for returns that straddle the rate-change date. There are also changes to the penalties rules to provide remission of late payment and late filing penalties and use-of-money interest in certain circumstances. These changes, which were included in the Taxation (Budget Measures) Act 2010, are explained below.

Key features

- The rate of GST will increase to 15% from 1 October 2010. All other key aspects of the GST rules are unaffected. The goods and services subject to GST are not being altered.
- The transitional rules that applied in 1989 will, with some minor modification, apply to this latest rate change.

Application date

All changes apply from 1 October 2010.

Detailed analysis

The minor legislative changes to the GST transitional provisions are:

Rate references

The rate specified in the GST Act has been amended so that businesses and organisations registered for GST are required to account for GST at the new rate of 15% from 1 October 2010. This also applies to goods imported on or after 1 October 2010. Accordingly, the rate references in sections 8(1) and 12(1) have been changed from "12.5" to "15". The rate reference in section 10(6), which sets the GST rate charged on goods and services provided to individuals in long-term commercial accommodation, has also been changed, from "7.5" to "9".

Contract prices

Some commentators suggested that there was interpretative uncertainty over whether contract prices expressed as "inclusive of GST" could be increased by the amount of the GST rate increase. Given that many contracts are expressed on a GST-inclusive basis, this issue has been put beyond doubt by amending the relevant section of the GST Act. The policy intent is clear that contract prices expressed as GST-inclusive should be able to be adjusted.

The uncertainty arises from the words in section 78(2) of the GST Act "or where the alteration in the law has been taken into account". Accordingly, these words have been removed.

Deemed supplies

The GST Act deems supplies to take place in certain situations, such as when there is a fringe benefit, entertainment expenditure and change of use. Since the last GST rate increase in 1989, a number of changes have been made to these time of supply rules, aimed at reducing compliance costs by enabling taxpayers to file less frequently.

In the absence of further legislative change, an unintentional result would have been that when the GST rate was increased, some transactions that took place before the rate-change date would have been subject to the new higher rate, in effect applying the rate change in advance of 1 October 2010. Accordingly, additional transitional provisions ensure that the old rate applies in these cases, so that registered persons are neither disadvantaged nor advantaged by the rate change. These changes are outlined below.

[2] Although the time-of-supply rules determine when GST-registered persons are required to recognise a liability for GST, the accounting basis adopted by the registered person can alter the taxable period in which that liability must be disclosed to Inland Revenue.

This issue does not arise for FBT as under the FBT time of supply rule the supply is treated as taking place at the time the fringe benefit is or is deemed to be provided or granted. This means that the GST on fringe benefits provided before 1 October will be charged at 12.5%.

Entertainment expenditure

In the absence of the additional transitional provisions, that part of entertainment expenditure that was precluded from being deducted would have been subject to the higher rate of GST as the supply would normally have been recognised on the date the registered person furnished their income tax return for the tax year, irrespective of when within the year the entertainment took place.

New section 21I(4B) of the GST Act provides a registered person with the option, for the 2010–11 tax year, of using the normal time of supply rule applicable to the deemed supply, or treating the entertainment expenditure incurred before 1 October 2010 as being supplied on 30 September 2010. The expenses incurred over the rest of the tax year would be recognised on the date the registered person furnishes their income tax return for the 2010–11 tax year.

Change-of-use adjustments

Supplies are deemed to occur when there is a change of use. Goods and services intended originally for business purposes may be used for making non-taxable supplies (that is, for exempt or private purposes). In this case output tax is payable. Conversely, goods and services intended originally for exempt or private purposes may be used in the registered person's business. In this case there is a deduction from output tax (calculated as the tax fraction applied to the lower of the market value or cost price of the good or service).

Some registered persons will be making the respective output tax or deduction from output tax in a period other than the taxable period in which there is a change of use. For example, many registered persons make the tax adjustment after the end of the tax year as part of finalising their annual accounts—the adjustments for 2010 would therefore be made in mid-2011. In this situation, and in the absence of additional transitional provisions, the higher GST rate may have applied even when the change of use took place before 1 October 2010.[3]

To ensure the old rate applies in such instances, the legislation has been amended, with regard to a deduction from output tax, to require a registered person to identify items that changed to a business use before 1 October 2010 and to apply a rate of 12.5% to them even if the deduction is made on or after 1 October. The legislative change makes it clear that the tax fraction mentioned in section 21F(1) is, in such cases, the tax fraction at the time the goods were acquired by the registered person.

Similarly, when output tax is required to be paid as a result of the change of use, the legislation explicitly provides the registered person with the additional option of identifying items that changed to a private use before 1 October 2010 and applying a rate of 12.5% to them, even if the output tax is attributed on or after 1 October 2010.

These changes are covered by the definition of "COU tax fraction" and new section 21CB.

Return filing

When there is a rate change, the transitional mechanism in section 78B avoids the need for special time-of-supply rules for registered persons returning GST on a payments or hybrid basis. The adjustment also affects persons on an invoice basis who have purchased second-hand goods for their business which meet the "qualifying supplies" definition. All the amounts that they pay or receive are accounted for at the new rate but with an adjustment to recognise the fact that the time of supply for some of the transactions would have been before the rate change date.

Basically, the adjustment mechanism takes the difference between a registered person's debtors and creditors immediately before the rate change and multiplies it by the difference between the old and new tax fractions. If the result is a positive amount (that is, creditors on hand exceed debtors on hand) it is treated as output tax in the return period. If it is negative (that is, debtors exceed creditors), the amount must be set off against GST liabilities in the preceding return period, with any balance being carried forward for use in the current return period, and so on.

Some minor legislative changes have been made to these rules to simplify the Act's return filing and record-keeping requirements for returns that straddle the rate change date.

The legislative changes are:

- The requirement (in former section 78B(2)(b)) that the registered person furnish the form on which they do their adjustment calculation to the Commissioner, has been being removed. Instead, registered persons only need to retain the form as part of their records, and include the adjustment with any other GST adjustments relevant to that return period. As a consequence of the removal of section 78B(2)(b), section 78B(4) which cross-referred to section 78B(2)(b), has been amended to include the references that were in section 78B(2)(b)(i) and (ii).
- Any excess credits can now be offset against the registered person's other tax liabilities, or even refunded.

[3] This means, for example, that when a deduction in output tax is required, the deduction from output tax would be at the rate of 15% even though output tax would have been originally paid at 12.5% when the good or service was purchased.

Application of penalties and use-of-money interest

New section 183AA of the Tax Administration Act 1994 provides for the automatic remission of late payment and late filing penalties and use-of-money interest in certain circumstances. Those circumstances are:

- that the lateness in filing or paying is reasonably attributable to the change in the GST rate (for example, the required systems changes to accommodate the new rate have not been able to be made in time); and
- the registered person has made reasonable efforts to comply and, therefore, shortfall penalties such as lack of reasonable care, would not be applicable.

If a shortfall penalty is imposed, the registered person is not eligible for the remission of late payment/late filing penalties and use-of-money interest under the proposed new remission provision. The remission is for a limited time, focusing on the transitional return period(s). Inland Revenue's media release of 27 May 2010 provides further detail.

Further legislative changes to section 139B of the Tax Administration Act ensure that the remitted penalties do not affect the late payment penalty grace period. That grace period allows a taxpayer to make an occasional error without the late payment penalty being imposed.

Legislative adjustment of tax credits for price increases

These adjustments are provided through several amendments to the Income Tax Act 2007—see amended sections MD 3 and ME 1 and new sections MF 4D and MF 4E. Sections MF 4B and MF 4C have been repealed as a consequence.

WORKING FOR FAMILIES: REMOVING THE AUTOMATIC INDEXATION OF THE ABATEMENT THRESHOLD AND EXCLUDING INVESTMENT LOSSES

Sections MB 3 and MF 7 of the Income Tax Act 2007

The Taxation (Budget Measures) Act 2010 introduced a number of changes that affect the calculation of Working for Families (WFF) tax credits:

- the indexation of the abatement threshold for WFF tax credits has been removed; and
- investment losses, such as losses from rental properties, are now excluded from the calculation of income for WFF tax credit purposes.

Background

Under the previous rules, the amount of the Family Tax Credit (the main WFF tax credit) and the abatement threshold were both automatically indexed to the Consumer Price Index (CPI).

Households earning over the current abatement threshold of $36,827 benefited from the indexation of both the amount of the Family Tax Credit (FTC) as well as the income level at which it abates. Households earning below $36,827 only benefited from the indexation of the amount of FTC. This made the FTC inequitable and inefficient at targeting those on lower incomes.

Certain adjustments are made to the calculation of income for WFF tax credit purposes. Currently, business losses are excluded from the calculation of income for WFF purposes but investment losses are not.

Key features

Section MF 7(1) has been amended so that the threshold at which WFF tax credits begin to abate is no longer automatically indexed to inflation. However, this abatement threshold can be changed by an Order in Council if the Government wishes. The amount of Family Tax Credit continues to be automatically indexed to inflation. Removing the indexation of the abatement threshold does not impact on families with nominal incomes below the current $36,827 threshold.

Section MB 3 has been amended to exclude investment losses such as rental losses from the calculation of family scheme income for WFF tax credit purposes. This means that if a person has or carries on an investment activity in an income year, and that investment produces a net loss, the income and deductions from that investment are ignored when calculating family scheme income for WFF tax credit purposes. An investment activity includes the passive holding of an investment asset such as a rental property, but does not include a bank account. This measure is intended to improve the integrity of the WFF scheme by preventing higher income people gaining access to assistance they would not normally be entitled to.

Application dates

The amendment removing automatic indexation of the abatement threshold applies from 20 May 2010.

The amendment excluding investment losses from the calculation of income for WFF tax credit purposes applies from 1 April 2011.

LEGISLATION AND DETERMINATIONS

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

DETERMINATION S16: FINANCIAL ARRANGEMENT INCOME OR EXPENDITURE FROM CERTAIN RETIREMENT VILLAGE ARRANGEMENT

This Determination may be cited as Determination S16: *Financial arrangement income or expenditure from certain retirement village arrangement.*

1. Explanation (note that the explanation does not form part of the determination)

(1) This Determination relates to an Occupation Right Agreement between the Operator and the Resident.

(2) The Occupation Right Agreement constitutes a financial arrangement in which the Resident provides money to the Operator. For the duration of the Occupation Right Agreement, the Operator provides the Resident with accommodation and associated services. On finding a new Resident to live in the villa that the original Resident exited, the Operator pays the original Resident the Termination Payment.

(3) As a lease is an excepted financial arrangement under section EW 5(9) of the Income Tax Act 2007, only the Initial Fee and Termination Payment are regarded as amounts for the purposes of calculating aggregate income or expenditure. Any income or expenditure solely attributable to the lease is disregarded.

(4) Under section EW 6 of the Income Tax Act 2007, the amount of the gross income deemed to be derived or the expenditure deemed to be incurred by a person in respect of a financial arrangement under the Financial Arrangements Rules shall not include any amounts that are solely attributable to an excepted financial arrangement that is part of the financial arrangement.

(5) This Determination prescribes the method to be used when calculating for Financial Arrangements Rules purposes the aggregate income derived or aggregate expenditure incurred in respect of the Occupation Right Agreement for both the Operator and the Resident. It details which amounts are to be included for this calculation and which amounts are attributable to an excepted financial arrangement.

(6) This Determination does not consider the spreading of income or expenditure under the Financial Arrangements Rules in relation to the Occupation Right Agreement. In this regard, see subpart EW of the Income Tax Act 2007.

2. Reference

(1) This Determination is made under section 90AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

(1) This Determination applies only to the Occupation Right Agreement described as follows:

The Operator and Resident enter into the Occupation Right Agreement. The Resident pays the Operator the Initial Fee. The Termination Payment (which is equal to the Initial Fee) is paid to the Resident or the Resident's estate on termination of the Occupation Right Agreement.

The Resident pays the Accommodation Payment to the Operator. The Accommodation Payment accrues daily. The Accommodation Payment each year is equal to 7 percent of the Initial Fee. The Accommodation Payment can only ever accrue to 35 percent of the Initial Fee.

The Accommodation Payment is offset against the Termination Payment at the termination of the Occupation Right Agreement.

The Village Expenses Payment is a yearly amount the Resident pays in monthly instalments to the Operator. This payment covers costs, expenses, and fees associated with the operation of the Village, such as wages, taxes, rates, levies, water, gas, electricity, and maintenance.

The Operator provides accommodation and associated services to the Resident.

4. Principle

(1) The Occupation Right Agreement has both financial arrangement and excepted financial arrangement components.

(2) When calculating income or expenditure in relation to the Occupation Right Agreement it is first necessary to separate the two components (financial arrangement and excepted financial arrangement) of the Occupation Right Agreement.

(3) This Determination specifies that the:

- Initial Fee and Termination Payments relate to the financial arrangement component; and

- Accommodation Payment and Village Expenses Payments relate to the lease component of the Occupation Right Agreement, which is an excepted financial arrangement and will be excluded from the application of the Financial Arrangements Rules when calculating income or expenditure for the Operator.

5. Interpretation

(1) In this Determination, the following expressions (which have not been defined elsewhere within the Determination) have the following meanings:

Initial Fee means the lump sum payable by the Resident to the Operator on entering into the Occupation Right Agreement.

Termination Payment means the lump sum payable by the Operator to the Resident on termination of the Occupation Right Agreement and the signing of a new Occupation Right Agreement with a new Resident who will occupy the villa that the departing Resident previously occupied.

Operator means operator of the Retirement Village.

Resident means a resident of the Retirement Village.

Accommodation Payment means the amount payable in consideration for the supply of accommodation to the Resident. The Accommodation Payment accrues daily, up to a maximum of 35 percent of the Termination Payment, at 7 percent per year.

Village Expenses Payment means the amount payable in consideration for the supply of accommodation to the Resident. It includes all costs, charges, expenses, wages, salaries, fees, and other outgoings paid or payable in relation to the management, supervision, and operation of the Village.

6. Method

(1) In respect of income, gain or loss, or expenditure, and any other consideration receivable by the Operator or payable by the Resident, the amounts not to be taken into account to calculate income or expenditure are the:

(a) Accommodation Payment; and

(b) Village Expenses Payment.

(2) In respect of income, gain or loss, or expenditure, and any other consideration receivable by the Operator or payable by the Resident, the amounts to be taken into account to calculate income or expenditure are the:

(a) Initial Fee; and

(b) Termination Payment.

7. Examples

Example A

(1) Example A illustrates the application of the method (set out in the Determination) for determining the amounts attributable to both the financial arrangement and excepted financial arrangement components of the Occupation Right Agreement between the Resident and the Operator.

(2) Example A assumes the:

(a) Resident occupies a unit from 19 August 2009 until 31 March 2012;

(b) Initial Fee and Termination Payment are $300,000 each;

(c) Accommodation Payment is an amount equal to 7 percent of the Initial Fee per year, accruing to a maximum of 35 percent of the Initial Fee; and

(d) Village Expenses Payment is $1,200 per year payable in equal monthly instalments.

(3) On 5 August 2009, a Resident enters into an Occupation Right Agreement with the Operator. The Resident pays a deposit of $5,000 of the Initial Fee. The balance of $295,000 of the Initial Fee is paid to the Operator on the commencement date of the Occupation Right Agreement, 19 August 2009.

(4) The Resident leaves the Village on 13 March 2012, and the Occupation Right Agreement terminates on that date. The Operator locates a replacement Resident on 10 June 2012 and pays the Resident the Termination Payment of $300,000 on that date.

(5) The two amounts that are solely attributable to the excepted financial arrangement are as follows.

(a) The Accommodation Payment accrues daily from 19 August 2009 until 13 March 2012 at 7 percent per year of the Initial Fee. There are two years from 19 August 2009 to 18 August 2011, and 206 days from 19 August 2011 to 13 March 2012. This is equal to 2.564 years. Therefore, the Accommodation Payment is equal to 17.948 percent (7 percent per year for 2.564 years) of $300,000:

Accommodation Payment = $53,844.

(b) The Village Outgoing Payment is a yearly charge of $1,200 payable in equal monthly instalments of $100. The Resident pays each instalment monthly from 19 August 2009 until 13 March 2012, for a total of 31 months. The total Village Outgoing Payment equals 31 times $100:

Village Outgoing Payment = $3,100.

(6) The aggregate amount attributable to the financial arrangement component of the Occupation Right Agreement, and therefore to be taken into account under the Financial Arrangements Rules, is $0 ($300,000 less $300,000), comprising the Initial Fee and Termination Payment. This amount constitutes aggregate income/expenditure under the Financial Arrangements Rules. All other amounts payable under the Occupation Right Agreement relate to the excepted financial arrangement component of the Occupation Right Agreement, so should not be taken into account when calculating income or expenditure.

(7) Note that example A deals only with the amounts attributable to the excepted financial arrangement and financial arrangement components of the Occupation Right Agreement. Example A does not deal with the attribution or spreading, under the Financial Arrangements Rules, of income or expenditure to particular income years. However, there is no aggregate income or expenditure in any income years.

Example B

(8) Example B illustrates the application of the method (set out in the Special Determination) for determining the amounts attributable to both the financial arrangement and excepted financial arrangement components of the Occupation Right Agreement between the Resident and the Operator.

(9) Example B assumes the:

- (a) Resident occupies a unit from 24 January 2010 until 14 August 2018;
- (b) Initial Fee and Termination Payment are $300,000 each;
- (c) Accommodation Payment is an amount equal to 7 percent of the Initial Fee per year, accruing to a maximum of 35 percent of the Initial Fee;
- (d) Village Expenses Payment is $1,200 per year payable in equal monthly instalments;
- (e) Termination Payment is not paid until 2 August 2019.

(10) On 3 January 2010, a Resident enters into an Occupation Right Agreement with the Operator. The Resident pays a deposit of $5,000 of the Initial Fee. The Resident pays the balance of the Initial Fee ($295,000) to the Operator on the commencement date of the Occupation Right Agreement, 24 January 2010.

(11) The Resident leaves the Village on 14 August 2018, and the Occupation Right Agreement terminates on that date. The Operator locates a replacement Resident on 24 October 2018 and pays the Resident the Termination Payment of $300,000 on that date.

(12) The amounts solely attributable to the excepted financial arrangement are as follows.

- (a) The Accommodation Payment accrues daily from 24 January 2010 until 14 August 2018 at 7 percent per year of the Initial Fee, to a maximum of 35 percent of the Initial Fee. There are eight years from 24 January 2010 to 23 January 2018, and 202 days from 24 January 2018 to 14 August 2018. This is equal to 8.553 years. Therefore, the Accommodation Payment is equal to 35 percent (7 percent per year until a maximum of 35 percent) of $300,000:

  Accommodation Payment = $105,000.

- (b) The Village Outgoing Payment is a yearly charge of $1,200, payable in equal monthly instalments of $100. The Resident pays $100 monthly from 24 January 2010 until 14 August 2018, a total of 103 months. The total Village Outgoing Payments equals 103 times $100:

  Village Outgoing Payment = $10,300.

(13) The aggregate amount attributable to the financial arrangement component of the Occupation Right Agreement, and therefore to be taken into account under the financial arrangements rules is $0 ($300,000 less $300,000), comprising the Initial Fee and Termination Payment. This amount constitutes aggregate income/expenditure under the Financial Arrangements Rules. All other amounts payable under the Occupation Right Agreement relate to the excepted financial arrangement component of the Occupation Right Agreement, so should not be taken into account when calculating income or expenditure.

(14) Note that example B deals with the amounts attributable only to the excepted financial arrangement and financial arrangement components of the Occupation Right Agreement. Example B does not deal with the attribution or spreading, under the Financial Arrangements Rules, of income or expenditure to particular income years. However, there is no aggregate income or expenditure in any income years.

This Determination is signed by me on the 6th day of June 2010.

Martin Smith

Chief Tax Counsel (Office of the Chief Tax Counsel)

LEGISLATION AND DETERMINATIONS

EQUESTRIAN ARENAS: CONSISTING OF PERMANENT CONSTRUCTION MATERIALS – DEPRECIATION

The Commissioner has set a provisional depreciation rate for equestrian arenas consisting of permanent construction materials.

Equestrian arenas are made up of several layers. The first layer is a base course consisting of compacted and graded material such as rock, or rubble such as old bricks or roading material. This layer is permanent and does not come within the meaning of "depreciable property".

The next layer, the scalpings, is used to even out the base course. Sand and then a top course consisting of chopped rubber or similar material complete the arena.

Over a number of years the top three layers (the scalpings, the sand and the top surface) will mingle and lose their separate properties. Eventually, it will be necessary to remove and replace these layers. This will not be the case with the base course which is likely to get better and more stable over time.

Expense item

The top surface may degrade relatively quickly as the top three layers mingle. It may be necessary to top up this top surface from time to time as ongoing repairs and maintenance.

DETERMINATION PROV20: TAX DEPRECIATION RATES PROVISIONAL DETERMINATION NUMBER PROV20

This determination may be cited as "Determination PROV20: *Tax depreciation rates provisional determination number PROV20*".

1. Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the table below.

This determination applies for the 2010/2011 and subsequent income years.

2. Determination

Pursuant to section 91AAG of the Tax Administration Act 1994 I set in this determination the provisional rate to apply to the kind of items of depreciable property listed in the table below by:

- adding into the "Agriculture, horticulture and aquaculture" and "Leisure" industry categories, and the "Buildings and structures" asset category, the provisional asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Provisional asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Equestrian arena consisting of permanent construction materials (excluding the base course)	12.5	16	10.5

3. Interpretation

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

This determination is signed on the 16th day of July 2010.

Rob Wells

LTS Manager, Technical Standards

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 10/04: NON-RESIDENT CONTRACTOR SCHEDULAR PAYMENTS

This interpretation statement replaces "Non-resident contractor's withholding tax – who is affected by the withholding tax rules", *Tax Information Bulletin* Vol 6, No 14 (June 1995).

All legislative references in this interpretation statement are to the Income Tax Act 2007 ("ITA 2007") unless otherwise stated.

This item addresses some interpretative issues and other practical matters related to non-resident contractor's tax on schedular payments, previously referred to as "withholding payments".

Introduction

1. This interpretation statement replaces "Non-resident contractor's withholding tax – who is affected by the withholding tax rules", *Tax Information Bulletin* Vol 6, No 14 (June 1995). This interpretation statement covers aspects of schedular payments to non-resident contractors that were covered in the *Tax Information Bulletin* item, in the context of the new legislative provisions.
2. The following aspects, which were covered in the *Tax Information Bulletin* item are discussed in this interpretation statement:
    - the imposition of tax on schedular payments to non-resident contractors, in particular the relevant rate that is provided in Schedule 4, special tax rate certificates, and exemption certificates;
    - the payment of tax to the Commissioner, in particular the amount of tax;
    - who is liable for paying the tax;
    - the non-resident contractor's tax obligations as a payer of PAYE income payments to subcontractors or employees; and
    - specific exemptions for non-resident contractors and non-resident employees from New Zealand tax, including relief under double tax agreements.
3. Information on applications and enquiries are at the end of this interpretation statement, followed by examples illustrating how the non-resident contractor provisions operate. There is also a flow chart diagram setting out steps to be followed.

Background

4. Before the introduction of the ITA 2007, the term "non-resident contractor's withholding tax" referred to the tax that generally must be withheld from payments to non-resident contractors and paid to the Commissioner.
5. Before the ITA 2007 the legislation relating to withholding payments was contained in the Income Tax (Withholding Payments) Regulations 1979 ("the Regulations") and the Income Tax Act 2004. This legislation has been repealed by the ITA 2007 effective with respect to income derived in the 2008/09 and later income years. The legislation relating to tax to be withheld and paid on payments to non-resident contractors is now contained in the ITA 2007 and the Tax Administration Act 1994 ("TAA"). The term "withholding payments" has been replaced by "schedular payments" in the ITA 2007 and the TAA. The term "schedular payments" refers generally to payments, other than salary or wages, of a kind set out in the classes listed in Schedule 4. All of the payments listed in Schedule 4 relate to payments under a contract for services, as opposed to payments under a contract of service. A contract of service means that the parties are in an employee/employer relationship whereas under a contract for services the parties are independently contracted. For further discussion of the differences between a contract of service and a contract for services see the Supreme Court judgment in *Bryson v Three Foot Six Ltd* [2005] 3 NZLR 721.
6. Generally, the payer of a schedular payment to a non-resident contractor is required to apply the PAYE rules to the payment. Under the PAYE rules, the payer of a

schedular payment to a non-resident contractor must withhold an amount of tax calculated on the gross amount of the payment generally at the relevant rate set out in Schedule 4. The relevant rate is generally 15 percent for schedular payments to non-resident contractors (except if it is a payment to which the source is specifically provided for in another part of Schedule 4 that is taxed at a different rate). The non-resident contractor may get relief from the amount of tax withheld by obtaining a certificate of exemption or a special tax rate certificate from the Commissioner.

7. Schedule 4 provides a 20 percent rate of tax on payments to non-resident entertainers for providing schedular entertainment activities. For more information on non-resident entertainers, see Inland Revenue's *Employer's guide (IR 335)*.

8. Non-resident contractors may be natural or non-natural persons, including companies. Payments to non-resident contractors that are companies can be schedular payments, unlike payments to most resident contractors that are companies (except for agricultural, horticultural, and viticultural companies).

Tax on schedular payments to non-resident contractors

9. The payer of a schedular payment to a non-resident contractor must generally withhold tax from the payment at either the relevant rate provided in Schedule 4, or a special tax rate the Commissioner has specified in a special tax rate certificate. Tax is not required to be withheld from a contract payment to a non-resident contractor if the non-resident contractor holds an exemption certificate in respect of the payment.

Relevant rate in Schedule 4

10. The relevant rate for schedular payments to non-resident contractors is generally the rate of 15 percent that is provided for contract payments to non-resident contractors in Part A of Schedule 4. However, if the schedular payment is a kind of payment to which the source is specifically provided for in another part of Schedule 4 (eg, clause 1 of Part F of Schedule 4, which provides a 25 percent rate of tax to apply specifically to payments for media contributions carried out by freelance contributors), then the relevant rate is the rate provided for that specific source of payment.

11. The reason the other schedular payment categories (formerly the withholding payment categories) are to be considered and applied before the non-resident contractor category is because the other categories have always been generally applicable to non-residents. From the time that the categories were introduced in 1957, there has been no general exclusion of payments to non-residents. The non-resident contractor category, which was first introduced in 1981, was an extension to the withholding payment categories. The non-resident contractor category was intended first, from 1981, to cover non-resident contractors performing work associated with "contract projects" that were not already covered by the withholding payment categories. "Contract projects" were projects involving construction, installation, assembly, exploration, exploitation or other similar activities. Then, from 1990, the non-resident contractor category was extended to cover all other non-resident contractors not already covered by the other withholding payment categories.

12. It is acknowledged that it is not entirely clear in the legislation that the other schedular payment categories are to be considered and applied before the non-resident contractor category. This is particularly so with the ITA 2007, where the non-resident contractor category comes first in Schedule 4 rather than last as was the case in the Schedule to the Regulations.

13. However, application of the non-resident entertainer class of payment provides another indication that this is the correct interpretation. Clause 4 of Part F of Schedule 4 provides a rate of 20 percent for payments to non-resident entertainers that provide or perform schedular entertainment activities. The definition of "non-resident contractor" is broad enough to include those who are also defined as a "non-resident entertainer", and the definitions of "contract payment" and "contract activity or service" are broad enough to cover payments for "schedular entertainment activities". Therefore, the specific non-resident entertainer class of payment would be redundant if the correct interpretation were that the non-resident contractor rate applies to all contract payments that relate to a non-resident contractor's contract activity or service. Therefore, the preferred interpretation is that the non-resident contractor rate is to be applied only when there is no other rate that could apply.

Special tax rate certificates

14. Section 24N of the TAA provides the Commissioner with the discretion to issue a special tax rate certificate, to a person entitled to receive a schedular payment, which specifies the amount of tax on the payment or the rate of tax applying to the payment. However, section 24N(2) of the TAA provides that special tax rate certificates cannot be issued in respect of schedular payments to non-resident entertainers. Also, it is not

the Commissioner's practice to issue a special tax rate certificate that applies retrospectively.

15. A non-resident contractor may apply to the Commissioner for a special tax rate certificate. The Commissioner may issue a certificate with a rate higher or lower than the rate provided in Schedule 4 for the schedular payment. A non-resident contractor may request a special tax rate to be aligned with the non-resident contractor's New Zealand marginal tax rate, which is determined by the non-resident contractor's taxable income as defined in the ITA 2007. Therefore, the special tax rate may be determined based on any relevant factors such as the expected revenue and expenditure of the contract, and the non-resident contractor's other sources of income or losses.

16. A payment made to the non-resident contractor for the use of, or right to use personal property is a schedular payment taxed at 15 percent pursuant to Part A of Schedule 4. However, several double tax agreements ("DTAs") that New Zealand has signed have a "royalties" article that includes as royalties, payments for the use of, or the right to use, industrial, commercial or scientific equipment. Therefore, a non-resident contractor who has received a schedular payment for the use of, or right to use personal property may request a special tax rate to align with the tax rate provided in the "royalties" article of the relevant DTA. An example that includes payments for the use of, or the right to use, industrial, commercial or scientific equipment as royalties is Article 12 of the Double Taxation Relief (Republic of South Africa) Order 2004. Under Article 12 of the Double Taxation Relief (Republic of South Africa) Order 2004 the tax shall not exceed 10 percent of the gross amount of the royalties. However, if those royalties are effectively connected with a permanent establishment of the non resident contractor in New Zealand, those royalties will be considered under Article 7 (business profits). As individual DTAs can be different and are subject to change, the appropriate DTA will need to be considered when considering what the non resident contractor's marginal tax rate will be.

Exemption certificates

17. Section RD 24 provides that a non-resident contractor may apply to the Commissioner for an exemption certificate to be issued under section 24M of the TAA in respect of a contract payment. An exemption certificate can be applied for if one of the three conditions provided in section RD 24(1) are satisfied. However, section 24M(2) of the TAA provides that exemption certificates cannot be issued in respect of schedular payments to non-resident entertainers.

18. Section 24M of the TAA provides the Commissioner with the discretion to issue an exemption certificate that specifies payments to which no tax is to be withheld. An example of where a non resident contractor may apply for an exemption certificate is where it is clear there will be no final income tax liability. This may be because of the application of a DTA or because the income earned by the non resident contractor will not be assessable income under the ITA 2007 (eg, under section CW 19 which provides that amounts are exempt income where they are derived from performing personal or professional services during visits of 92 or fewer days in New Zealand and certain other requirements are satisfied).

19. An exemption certificate issued by the Commissioner will specify that no tax is to be withheld from specific payments stated on the certificate, and will specify the period for which the certificate is valid. It is not the Commissioner's practice to issue an exemption certificate that applies retrospectively. The Commissioner has previously required exemption certificates to be signed in order to be valid. The Commissioner has also required any expired exemption certificates to be returned to the Commissioner. Having reviewed the matter the Commissioner considers that the requirement to sign a certificate should remain but that, from the date of issue of this Interpretation Statement, non resident contractors will no longer be required to return any expired exemption certificates.

Payments of tax to the Commissioner

20. Section RD 4(1) provides that the payer of a schedular payment to a non-resident contractor is required to pay the tax withheld from that payment to the Commissioner.

21. Where a payment to a non-resident contractor has had tax withheld but the tax has not been paid to the Commissioner, the tax owing will be calculated from applying the applicable rate on the amount before the employer withheld tax. That is, tax will be calculated on the gross payment.

22. Also, where it is clear from the contract that the payer of the schedular payment is responsible for the tax on the payment (as determined from records and/or contracts) and no tax has been deducted, the payment to the non-resident contractor must be grossed up before the tax is calculated.

23. It is necessary to gross up the payment, in the above situations, because the payment is regarded as the net amount and therefore the payment must be grossed up to correctly tax that payment. The grossed up amount

is calculated by dividing the net amount by 1 minus the applicable withholding tax rate from Schedule 4 (eg 0.85 where the 15% non resident withholding tax rate is applicable).

Example

Where grossing up is required and the contract payment made to a non-resident contractor is $85, then the grossed up amount will be $100.

$85 ÷ (1 – 0.15) = $100

24. Section RD 4(2) provides that if the payer of a schedular payment to a non-resident contractor has not withheld the tax from the payment, and subsequently has not paid the tax to the Commissioner, then the non-resident contractor must pay the tax that should have been withheld. In such a case where the tax has not been withheld or where the non-resident contractor is responsible for the tax withheld (also determined from records and/or contracts), the non-resident contractor would have received a "before-tax" payment and so the tax owing is calculated from applying the applicable rate on the amount received. That is, the payment to the non-resident contractor is not grossed up before the tax is calculated.

Who is liable for paying the tax?

25. In cases where the payer of the schedular payment has withheld tax from the payment (or contracted to be responsible for the tax on the payment made) but has not paid the tax to the Commissioner, the payer of the schedular payment will be liable to pay the deficient tax. This is referred to as a failure to account.
26. Where tax has not been withheld, section 168 of the TAA provides that the tax owing constitutes a debt payable to the Commissioner by the payer of the schedular payment. This is referred to as a failure to deduct. Section 168 of the TAA provides the Commissioner with the right to recover the deficient tax from the payer, the non-resident contractor, or both concurrently. Therefore, in a case where the non-resident contractor has no continuing presence in New Zealand the Commissioner may solely seek payment from the payer of the schedular payment.

Subcontractors and employees of non-resident contractors

27. Pursuant to section RD 20, a non-resident contractor must withhold and pay tax on payments made to a subcontractor, if the payments are PAYE income payments (which mean payments of salary or wages, extra pay, and schedular payments).
28. Further, pursuant to section RA 5, a non-resident contractor who has employees or subcontractors, must account for and pay to the Commissioner all of the following as applicable:
    - tax on PAYE income payments;
    - fringe benefit tax;
    - tax on employer's superannuation contributions (including KiwiSaver contributions).
29. The non-resident contractor may also be required to fulfil obligations relating to accident compensation levies. For more information about employer's tax obligations, see Inland Revenue's *Employer's guide (IR 335)*.

Specific exemptions for non-residents from New Zealand tax

30. The question of whether a payment is exempt income under the ITA 2007 or whether the payment has full relief from New Zealand tax under a DTA is separate to whether or not that payment is a schedular payment. Therefore, tax on schedular payments to non-resident contractors must be withheld from the payment (even if the amount of the payment is exempt income under the ITA 2007 or the recipient has full relief from New Zealand tax under a DTA), unless the non-resident contractor holds an exemption certificate in respect of that payment.
31. However, pursuant to section RD 8(1)(b), a payment to a non-resident contractor will not be a schedular payment and so tax will not need to be withheld, if the payment is:
    - salary or wages; or
    - an extra pay; or
    - a payment for services provided by a public authority, a local authority, a Māori authority, or a company, other than a non-resident contractor, a non-resident entertainer, or an agricultural, horticultural, or viticultural company; or
    - a payment covered by an exemption certificate provided under section 24M of the TAA; or
    - a payment for services provided by a non-resident contractor who has full relief from tax under a DTA, and is present in New Zealand for 92 or fewer days in a 12-month period; or
    - a contract payment for a contract activity or service of a non-resident contractor when the total amount paid for those activities to the non-resident contractor or another person on their behalf is $15,000 or less in a 12-month period.

32. Section RD 8(1)(b)(v) provides that "a payment for services provided by a non-resident contractor who has full relief from tax under a double tax agreement, and is present in New Zealand for 92 or fewer days in a 12-month period" is not a schedular payment. The Commissioner considers that the words "full relief from tax under a double tax agreement" refer to each particular contract activity. This means that, for the purposes of section RD 8(1)(b)(v), each contract activity needs to be considered under any applicable DTA. Where a non-resident contractor is involved in more than one particular type of activity or investment, the fact that one or more of those activities or investments does not have full relief, under any applicable DTA, will not affect whether or not payments for the other activities are excluded from being schedular payments under section RD 8(1)(b)(v).
33. An example of the above interpretation of section RD 8(1)(b)(v) is where a non resident contractor undertakes a contract activity which has relief under a DTA but also earns interest or dividends which are only partially relieved under a DTA. The fact that the interest or dividends do not have full relief does not affect whether or not the contract payments for the other activities are schedular payments. In addition, while each particular contract activity is considered separately for the purposes of section RD 8(1)(b)(v), some DTAs link different activities and deem that connected activity to be a permanent establishment. An example is Article 5(4) of the Double Taxation Relief (Australia) Order 2010 (Article 5 contains the definition of a permanent establishment). In this case the particular activity being considered will not be considered to have full relief under that particular DTA for the purposes of section RD 8(1)(b)(v).
34. Section RD 8(1)(b)(vi) provides that "a contract payment for a contract activity or service of a non-resident contractor when the total amount paid for those activities to the contractor or another person on their behalf is NZ$15,000 or less in a 12-month period" is not a contract payment. The phrase "a contract payment for a contract activity or service" means that section RD 8(1)(b)(vi) must be considered each time a person makes a contract payment to a non resident contractor. The phrase "the total amount paid for those activities" means that all contract payments for all contract activities undertaken by a non resident contractor in a 12-month period are added together to determine "the total amount paid for those activities". Determining "the total amount paid for those activities" requires that the person paying the contract payment has regard to all New Zealand-sourced contract payments received by or on behalf of the non resident contractor and all contract payments to be received by or on behalf of the non resident contractor (from any person) in any 12-month period. For example, if a non resident contractor contracts with party A for NZ$10,000 in a 12-month period, and in that same period contracts with party B for NZ$20,000, the rule will not apply.
35. Section RD 23 provides that where it cannot reasonably be determined at the time of the PAYE income payment whether the payment will be exempt income of the non-resident contractor or non-resident employee under either section CW 19 or a DTA, then the payer of the PAYE income payment may apply to the Commissioner to be released from the obligation to withhold the amount by providing a bond or other security to the Commissioner for the amount that would otherwise be required to be withheld.

An interim tax

36. The tax required to be withheld from schedular payments to non-resident contractors is an interim tax. That is, the withheld tax is paid to the Commissioner towards the non-resident contractor's New Zealand income tax liability. The non-resident contractor's New Zealand income tax liability for a tax year is determined by an assessment of the contractor's taxable income for that year. The taxable income is then multiplied by the basic tax rate, at which stage a refund of any overpaid tax can be requested, or additional tax paid, by the non-resident contractor.

Relief under double tax agreements

37. A non-resident may be provided with relief from their New Zealand income tax liability if a DTA exists between New Zealand and the country in which the non-resident is a tax resident.
38. When considering whether a DTA provides a non-resident contractor with relief from New Zealand tax, common issues that arise are:
    - whether the income is a royalty as defined in the DTA;
    - if the non-resident contractor is an enterprise, whether it has a permanent establishment in New Zealand at the time the contract activity is performed;
    - if the non-resident contractor is an individual, whether relief is provided by the personal services articles of the DTA (often relief is based on the length of the visit and whether a fixed base is available to the non-resident contractor in New Zealand).

39. Many DTAs contain articles dealing with particular areas or industries, which may provide a non-resident contractor with relief from New Zealand tax. Although DTAs have many similarities, they can also differ, so relief provided under a DTA to a non-resident contractor from one country may not be provided under another DTA to a non-resident contractor from another country. Care should be taken in considering the effect of a DTA on any particular situation.
40. For the non-resident contractor's employees, relief may be available under the "Dependent Personal Services" or similar article in the DTA. These articles usually contain the following three requirements that an employee must meet to obtain relief under the DTA:
    - The employee's presence in New Zealand must not exceed in aggregate 183 days in a 12-month period.
    - The remuneration is paid by, or on behalf of, an employer who is not a resident of New Zealand.
    - The remuneration is not borne by a permanent establishment or fixed base that the employer has in New Zealand.
41. A non-resident who has a tax liability in New Zealand may still be required to declare New Zealand income in their country of tax residence. However, the non-resident may be able to claim some or all of the New Zealand paid taxes as a tax credit in the country of tax residence.

Applications and enquiries

42. Applications for exemption certificates must contain the following information:
    - the name and tax residence of the non-resident contractor;
    - a detailed description of the contract activity to be performed by the non-resident contractor in New Zealand, including start and finish dates of the contract activity to be performed in New Zealand;
    - a copy of the contract entered into between the non-resident contractor and the payer;
    - details of the contract period, contract payment amounts and their payment dates;
    - names of all the non-resident contractor's employees and/or subcontractors who will be present in New Zealand performing the contract activity, and their arrival and departure dates; and
    - a brief background of any previous contract activity performed in New Zealand in the past two years by the non-resident contractor, and comments on any anticipated contract activity that the non-resident contractor is likely to undertake in New Zealand in the future.
43. Applications for special tax rate certificates should include the same information as required for applications for exemption certificates, and also disclosure of anticipated total revenue and expenditure for the contract activity and any other anticipated income or losses that will be included in the non-resident's New Zealand taxable income.
44. Applications for an exemption certificate or a special tax rate certificate, or any enquiries about tax on payments to non-resident contractors should be made to:

    Non-Resident Contractors Team
    Inland Revenue
    PO Box 2198
    Wellington 6140
    New Zealand

    Telephone: 64 04 890 3056
    Facsimile: 64 04 890 4510
    Email: nr.contractors@ird.govt.nz
45. As well as tax on schedular payments to non-resident contractors, the Non-Resident Contractors Team also deals with the other associated tax issues of a non-resident contractor (ie, tax on other PAYE income payments, goods and services tax, and fringe benefit tax).

Examples

46. Unless specifically discussed, these examples assume that the contract payments are **not** excluded from being schedular payments by virtue of section RD 8(1)(b) and do not consider:
    - Whether the payment is exempt income under the ITA 2007 (in particular section CW 19), or
    - The effect of a DTA on the non-resident contractor's final tax liability.

Example 1

47. A non-resident individual specialises in the computer programming of robotics machinery. The non-resident is contracted by a New Zealand manufacturing company to undertake a two-month contract in New Zealand writing a computer program for one of the company's new automated plants. The contract for the non-resident's services as a computer software consultant is a contract for service as opposed to a contract of service. Therefore, the non-resident is a "non-resident contractor". The Commissioner notes that the schedular payment rules do not distinguish between a non-resident individual (who is an independent contractor) and a non-resident company.

48. In this example the non-resident contractor is present in New Zealand for 92 or fewer days. Therefore, under section RD 8(1)(b)(v), if the non-resident contractor is entitled to full relief under a DTA then the payment will not be a schedular payment. This means that tax would not need to be withheld from the payments to the non-resident contractor. However, if the non-resident contractor is not entitled to full relief under a DTA then the contract payments made under the contract will be schedular payments. This means that tax must be withheld from the payments to the non-resident contractor at the appropriate rate under Schedule 4.

49. Contract payments will also be schedular payments if the New Zealand manufacturing company contracts a non-resident company to provide the computer programming services, and that company sends one of its employees to New Zealand to perform the contracted services.

Example 2

50. A non-resident demolition expert is contracted by a New Zealand company to demolish a tall industrial chimney at one of the company's sites in New Zealand. The non-resident demolition expert is required to provide all the necessary equipment and personnel to carry out the contracted work, and brings an employee to New Zealand to assist in the demolition contract. The contract is a contract for services and therefore, the non-resident demolition expert is a "non-resident contractor". This means that the contract payments made under the contract to the non-resident demolition expert will be schedular payments unless the payment is excluded from being a schedular payment by section RD 8(1)(b).

51. The salary paid to the non-resident demolition expert's employee while the employee is present in New Zealand is sourced here in accordance with section YD 4(4). However the employee's salary is excluded from the definition of the term "schedular payment" under section RD 8(1)(b). The salary will however be within the definition of the term "PAYE income payment" in section RD 3. This means that the non-resident demolition expert will have to withhold PAYE and pay this to the Commissioner under the PAYE rules in subpart RD of the ITA 2007, unless the Commissioner is satisfied that the employee will be exempt from New Zealand tax under the ITA 2007 (eg section CW 19) or that the employee has full relief under a DTA.

Example 3

52. A non-resident company has vehicles, vessels, and aircraft available for worldwide hire. A New Zealand company contracts the non-resident company to supply a small submarine on bare boat charter for a period of eight months for use in New Zealand. The contract provides for payment of a monthly rental fee. Therefore, the non-resident company is a "non-resident contractor" that is receiving payments for a "contract activity or service", being the provision of the use, in New Zealand, of the non-resident's personal property.

53. The contract also provides the New Zealand company with an option to have the non-resident company supply suitably qualified personnel to operate the submarine. An additional fee is charged for these services. The New Zealand company does not have a suitably qualified operator to operate the submarine, so it exercises its option under the contract. The non-resident company has on call several independent operators who it may contract. The non-resident company contracts a non-resident independent operator who is qualified to operate the submarine. The contract between the non-resident company and the non-resident independent operator is a contract for service and therefore the non-resident operator is a "non-resident contractor".

54. The contract payments that the New Zealand company makes to the non-resident company for the hire of both the submarine and the personnel are schedular payments to which the New Zealand company must withhold tax. The contract payments by the non-resident company to the non-resident independent operator are also schedular payments, and the non-resident company must also withhold tax on these schedular payments.

Example 4

55. A New Zealand company engages the services of a marketing company in Melbourne to undertake a marketing study in Australia of possible consumer interest in small appliances that are manufactured in New Zealand. The contract services provided by the Melbourne company are not performed in New Zealand. Therefore, the income does not have a source in New Zealand and consequently the payments will not be schedular payments. This means that tax will not need to be withheld from any payments for the company's services.

Example 5

56. A non-resident company specialising in the manufacture of compressed fibreboard fabricating machinery sells machinery to a New Zealand timber company that is in the business of manufacturing compressed fibreboards. Fabrication of the machinery takes place outside New Zealand, and the non-resident company arranges for transport of the machinery to the New Zealand company's premises. The machinery is all computer-controlled, and specially trained personnel are required to operate and maintain it.

57. The contract to supply the machinery includes the requirement for the non-resident company to supply specialist engineering personnel to supervise the installation of the machinery at the New Zealand timber company's New Zealand plant, and to provide the New Zealand company's personnel with training in the use and maintenance of the machinery.

58. The payments made for the actual supply of the machinery cannot be schedular payments, as there is no source in New Zealand. The machinery was fabricated outside New Zealand.

59. The contract payments made by the New Zealand company to the non-resident company for providing personnel to supervise the installation of the machinery and for the training services are schedular payments as both these activities are performed in New Zealand by the non-resident company, which is a "non-resident contractor".

60. The salary paid to the non-resident company's employee while the employee is present in New Zealand is sourced here in accordance with section YD 4(4). However the employee's salary is excluded from the definition of the term "schedular payment" under section RD 8(1)(b). The salary will however be within the definition of the term "PAYE income payment" in section RD 3. Therefore the non-resident company will have to withhold PAYE and pay this to the Commissioner under the PAYE rules in subpart RD of the ITA 2007, unless the Commissioner is satisfied that the employee will be exempt from New Zealand tax under the ITA 2007 (eg under section CW 19) or that the employee has full relief under a DTA.

Example 6

61. The New Zealand company in example 5 enters into a further agreement with the non-resident company to manufacture and market the compressed fibreboard fabricating machinery in New Zealand. The non-resident company grants the New Zealand company exclusive rights to manufacture, market, and distribute the machine in New Zealand. The licence granted entitles the New Zealand company to the use of the trademark and technical information, including specifications and plans, and access to the non-resident company's technical staff.

62. The New Zealand company pays a royalty to the non-resident company for the trademark and technical information. The non-resident company charges the New Zealand company an hourly rate for the services of its staff in support of the New Zealand company's operations.

63. The royalty payments are not schedular payments as a royalty (as defined in section CC 9(2) and (3)) is specifically excluded from the definition of "contract payment". Instead, the royalties paid for the trademark and technical information are subject to non-resident withholding tax, which is imposed under Subpart RF of the ITA 2007. (For more information on non-resident withholding tax contact the Non-resident Centre at nonres@ird.govt.nz, or on 64 03 951 2020.)

64. The fees paid to the non-resident company for the assistance provided by its staff also constitute royalties, as the fees come within the terms of paragraph (h) of the definition of "royalty" in section CC 9(2) and (3). Paragraph (h) provides that the supply of any assistance that enables the application of the trademark or technical information is also a royalty.

Example 7

65. A non-resident freelance journalist comes to New Zealand to report on the New Zealand visit of an important overseas dignitary. A New Zealand newspaper company contracts the non-resident journalist to write a cover story on the visit of the overseas dignitary, for which a contract fee is payable. The newspaper will hold all rights to the story written. The contract is a contract for service that the non-resident journalist performs in New Zealand. Therefore, the contract payments to the non-resident journalist will be schedular payments because the non-resident is a "non-resident

contractor" who is carrying out a "contract activity or service".

66. Although Part A of Schedule 4 provides a 15 percent rate of tax for contract payments to non-resident contractors, clause 1 of Part F of Schedule 4 provides a 25 percent rate of tax to apply specifically for payments for contributions by freelance journalists. Therefore, the 25 percent rate will apply to these contract payments.

Appendix One: Legislation

Schedular payments in subpart RD of the Income Tax Act 2007

67. Section RD 3(1) includes schedular payments as PAYE income payments.

RD 3 PAYE income payments

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:

68. Section RD 4(1) provides that the payer of the PAYE income payment must pay the required amount of tax withheld from the payment to the Commissioner. Section RD 4(2) provides that if some or all of the amount of tax for the PAYE income payment is not withheld and paid pursuant to section RD 4(1), then the recipient of the PAYE income payment must pay the tax.

RD 4 Payment of amounts of tax to Commissioner

Payments monthly or fortnightly

(1) An employer or PAYE intermediary who withholds an amount of tax for a PAYE income payment must pay the amount to the Commissioner as follows

(a) on a monthly basis, if they are an employer to whom section RD 22(3) or (4) applies:

(b) for 2 payment periods in a month, if paragraph (a) does not apply.

Liability when amount not withheld

(2) If some or all of the amount of tax for a PAYE income payment is not withheld and paid under subsection (1), the employee in relation to whom the payment is made must—

(a) pay an amount equal to the amount of tax to the Commissioner by the 20th day of the month following that in which the PAYE income payment was made; and

(b) provide an employer monthly schedule to the Commissioner by the date described in paragraph (a).

69. Section RD 8 provides that payments of the classes specified in Schedule 4 are schedular payments. Section RD 8(1)(b) excludes particular payments from being schedular payments.

RD 8 Schedular payments

Meaning

(1) **A schedular payment**—

(a) means—

(i) a payment of a class set out in schedule 4 (Rates of tax for schedular payments); and

(ii) in relation to a sale, the net amount paid after subtracting from the purchase price all commission, insurance, freight, classing charges and other expenses incurred by the seller in connection with the sale; and

(b) does not include—

(i) salary or wages; or

(ii) an extra pay; or

(iii) a payment for services provided by a public authority, a local authority, a Maori authority, or a company, other than a non-resident contractor, a non-resident entertainer, or an agricultural, horticultural, or viticultural company; or

(iv) a payment covered by an exemption certificate provided under section 24M of the Tax Administration Act 1994; or

(v) a payment for services provided by a non-resident contractor who has full relief from tax under a double tax agreement, and is present in New Zealand for 92 or fewer days in a 12-month period; or

(vi) a contract payment for a contract activity or service of a non-resident contractor when the total amount paid for those activities to the contractor or another person on their behalf is $15,000 or less in a 12-month period.

70. Section RD 10(3) provides that the amount of tax for a schedular payment is calculated from the gross amount of the schedular payment at the relevant rate set out in Schedule 4.

RD 10 Amounts of tax for PAYE income payments

...

Schedular payments

(3) The amount of tax for a schedular payment is determined—

(a) at the relevant rate set out in schedule 4 (Rates of tax for schedular payments); and

(b) on the basis of the gross amount of the payment, whether—

(i) some or all of the payment is income; and

(ii) the full income tax liability lies with the person receiving the payment, or lies partly with an employee or subcontractor of the person.

...

71. Section RD 18 provides the amount of tax that must be withheld by the payer of a schedular payment if notification required under section 24L of the TAA has not been provided to them.

RD 18 Schedular payments without notification

When this section applies

(1) This section applies when a person makes a schedular payment but the notification required under section 24L of the Tax Administration Act 1994 has not been provided to them.

When this section does not apply

(2) This section does not apply when a person other than a company incorporates a company to obtain a reduction in an amount of tax for a schedular payment.

Amount of tax

(3) The person must withhold the amount of tax for the schedular payment of an amount determined as follows:

(a) 5% of the amount of the schedular payment in addition to an amount calculated under section RD 10(3) if—

(i) the person receiving the payment is a company that is a non-resident contractor; and

(ii) the non-resident contractor receives the payment other than as a result of a choice that is made for purposes that include a purpose of defeating the intent and application of paragraph (c); and

(iii) paragraph (b) does not apply:

(b) zero, if the schedular payment is made to a non-resident entertainer:

(c) 15% of the amount of the schedular payment if paragraphs (a) and (b) do not apply.

Note: If the payer of the schedular payment has not been notified with a completed *Tax code declaration (IR 330)* by the non-resident contractor, as required by section 24L of the TAA, then the payer must withhold tax from the payment at the applicable rate specified in section RD 18(3), which is to be applied in addition to the rate of tax specified in Schedule 4.

72. Section RD 19 sets out the non-resident entertainer's obligation to forward the tax on a schedular payment to the Commissioner where that schedular payment has been received without having NRCT deducted.

RD 19 Schedular payments to non-resident entertainers

When this section applies

(1) This section applies when a non-resident entertainer derives income from an activity or performance connected with any of the activities or performances described in the definition of non-resident entertainer.

Amounts withheld [Repealed]

(2) [Repealed]

Amounts not withheld

(3) If the entertainer has received a schedular payment from which no amount of tax has been withheld, the entertainer must pay the amount of tax to the Commissioner by the 20th day of the month following that in which the payment was made, or by the date of their departure from New Zealand if that is earlier.

73. Section RD 20 provides that where a non-resident contractor is paid a schedular payment for services provided under a contract, and a subcontractor has provided services under that contract, the PAYE rules apply to the non-resident contractor in relation to payments to the subcontractor for the work carried out under the contract.

RD 20 Schedular payments to subcontractors

When this section applies

(1) This section applies when a contractor is paid a schedular payment for services provided under a contract, and a subcontractor has provided services under the contract.

Obligation to retain amount

(2) The PAYE rules apply to the contractor in relation to a payment made to the subcontractor in relation to the work carried out under the contract.

74. Section RD 24 provides that a non-resident contractor may apply to the Commissioner for an exemption certificate to be issued under section 24M of the TAA in respect of a contract payment. An exemption certificate can be applied for in respect of a contract payment for a contract activity or service if one of the three conditions provided in section RD 24(1) are satisfied.

RD 24 Exemption certificates for non-resident contractors

When this section applies

(1) This section applies when—

(a) a non-resident contractor derives an amount from a contract activity or service that is not income, whether because of a double tax agreement or for another reason; or

(b) the contractor provides a bond or other security for the payment of any income tax payable on an amount derived by them from a contract activity or service; or

(c) the contractor has in the period of 24 months before the date of the application referred to in subsection (2) paid all income tax payable by them and complied with their obligations under the Inland Revenue Acts, and the Commissioner is satisfied that the contractor will continue to do this.

Exemption certificate

(2) The non-resident contractor may apply to the Commissioner to provide them with an exemption certificate under section 24M of the Tax Administration Act 1994 for a contract payment made to them or another person acting on their behalf in relation to a contract activity or service set out in the certificate for which no amount of tax is to be withheld.

Note: An application for an exemption certificate for a non-resident contractor should be made on the application form IR 197.

Definitions in sections YA 1 and CC 9 of the Income Tax Act 2007

75. Section YA 1 includes a definition of a "non-resident contractor".

non-resident contractor, in the PAYE rules, means a person who—

(a) is not resident in New Zealand under subpart YD (Residence and source in New Zealand); and

(b) undertakes under a contract, agreement, or arrangement (other than a contract of service or apprenticeship)—

(i) to perform services of any kind in New Zealand:

(ii) to supply the use, or right to use, in New Zealand any personal property or services of another person

76. In relation to a non-resident contractor, section YA 1 contains definitions of a "contract activity or service" and a "contract payment".

contract activity or service, for a non-resident contractor, means—

(a) performing any work in New Zealand:

(b) rendering a service of any kind in New Zealand:

(c) providing the use of, or right to use, in New Zealand, any personal property or services of a person other than the non-resident contractor

Note: "Personal property" in (c) of the definition of "contract activity or service" means any property that is not land. Therefore, the definition of "contract activity or service" would include the lease of any type of equipment for use in New Zealand. This can be relevant when these provisions interface with certain DTAs. This is discussed further above in the "special tax rate certificates" section of this statement.

contract payment, for a non-resident contractor, means any payment other than—

(a) a royalty; or

(b) a payment made to the non-resident contractor by or on behalf of a person who is not associated with the contractor to reimburse costs incurred by the contractor; or

(c) a payment referred to in schedule 4, part E (Rates of tax for schedular payments)

Note: A royalty in the definition of "contract payment" is defined in section CC 9(2) and (3).

77. Section YA 1 also contains a definition of a "non resident entertainer".

non-resident entertainer is defined in section CW 20(4) (Amounts derived by visiting entertainers including sportspersons) for the purposes of that section, and in the PAYE rules, means a person who—

(a) is not resident in New Zealand under subpart YD (Residence and source in New Zealand); and

(b) undertakes a Part F activity

(c) Repealed.

Withholding rates found in Schedule 4 of the Income Tax Act 2007

78. Schedule 4 lists from Part A to Part I, a range of different types of activities and services for which a payment may be made and the relevant tax rate. Some examples of the types of activities provided for in schedule 4 are provided below.

Part A

Payments to non-resident contractors

1 A contract payment that relates to a non-resident contractor's contract activity or service has a 0.15 rate of tax for each dollar of the payment, if the payment is—

(a) to the non-resident contractor:

(b) to an agent of the non-resident contractor:

(c) to a person acting on behalf of the non-resident contractor.

…

Part D

Payments for commercial cleaning and maintenance work, or for general contracting

1 A payment for commercial cleaning or maintenance work has a 0.20 rate of tax for each dollar of the payment.

…

3 In this part,—

commercial cleaning or maintenance work means work or services that are related to schedular commercial land, if the work or services have the following nature

(a) cleaning all or part of premises:

(b) cleaning or laundering plant, vehicles, furniture, furnishings, fittings, or equipment:

(c) gardening (including grass cutting and hedge cutting):

(d) destroying vermin:

(e) destroying weeds

…

Part E

Payments for labour-only building work, or for labour-only fishing boat operating

1A payment for labour-only building work, or for labour-only fishing boat work, has a 0.20 rate of tax for each dollar of the payment.

2 In this part,—

labour-only fishing boat work means work or services under a contract, arrangement, or agreement for profit-sharing which is exclusively or substantially for the supply of labour in connection with operating or maintaining a fishing boat that is required to be registered under section 103 of the Fisheries Act 1996

labour-only building work means work or services under a contract or arrangement which is exclusively or substantially for the supply of labour in connection with a building or a construction (including pre-fabrication and pre-cutting for the relevant building or construction), if the work or services have the following nature

(a) work or services that, customarily, may form part of the work or services of a carpenter under a building contract:

(b) work or services connected with roof-fixing, steel-fixing, erecting fences, or laying concrete, bricks, blocks, tiles, slabs, or stones, if the relevant building or construction is not land that is used or intended to be used for farming or agriculture:

(c) work or services connected with hanging wallpaper, hanging decorative wall coverings or furnishings, or painting or decorating (including plastering):

(d) work or services connected with installing fibrous plaster, wallboard, insulating material, interior tiles, interior lining, floor tiles, carpet, linoleum, or floor coverings.

Part F

Payments for activities related to sports, media, entertainment, and public speaking

1 A payment of a media contribution fee, or of a promotional appearance fee, has a 0.25 rate of tax for each dollar of the payment.

…

7 In this part,—

media contribution fee means fees or remuneration, paid to a contributor, that relate to a contribution for television, radio, theatre, stage, or printed media

…

promotional appearance fee means fees or remuneration that relate to a personal attendance for exhibiting or demonstrating goods

…

Amounts derived during short-term visits are exempt income

79. Section CW 19 provides that certain income derived by a non-resident for services performed in New Zealand during a visit is exempt income.

CW 19 Amounts derived during short-term visits

Exempt income

(1) Income that a non-resident person derives in a tax year from performing personal or professional services in New Zealand during a visit is exempt income if—

(a) the visit is for 92 or fewer days, counting the days of arrival and departure as a whole day each; and

(b) the total number of days on which the person is present in New Zealand in the tax year is 92 or fewer; and

(c) the services are performed for or on behalf of a person who is not resident in New Zealand; and

(d) the amount derived from the personal or professional services is chargeable in the country or territory in which the person is resident with a tax that is substantially the same as income tax imposed under this Act.

Exclusion

(2) This section does not apply to the income of a public entertainer.

Meaning of public entertainer

(3) In this section, public entertainer includes—

(a) circus performers, dancers, lecturers, motion picture artists, musicians, radio artists, singers, television artists, and theatre artists; and

(b) athletes, boxers, wrestlers, and other professional sportspersons.

Tax Administration Act 1994

80. Section 24L of the TAA provides that the recipient of a schedular payment must notify the payer of the applicable schedular tax code before receiving the payment.

24L Schedular notification

(1) This section applies to a person who is entitled to receive a schedular payment described in section RD 8 of the Income Tax Act 2007.

(2) Before the person receives the schedular payment, they must notify the person making the payment of the applicable schedular tax code.

(3) The notification referred to in subsection (2) must be in a form authorised by the Commissioner.

81. Section 24M of the TAA provides the Commissioner with the discretion to issue an exemption certificate that specifies payments to which no tax is to be withheld.

24M Exemption certificates for schedular payments

(1) The Commissioner may provide a person who is entitled to receive a schedular payment with an exemption certificate setting out the payments for a period for which no amount of tax is to be withheld.

(2) Subsection (1) does not apply to a payment to a non-resident entertainer.

(3) The Commissioner may cancel an exemption certificate at any time.

(4) If the Commissioner cancels an exemption certificate, the person who was provided the certificate must return it within 7 days of the date of cancellation.

(5) An exemption certificate must not be altered or be used to cause a person making a schedular payment not to withhold an amount of tax for the payment.

82. Section 24N of the TAA provides the Commissioner with the discretion to issue a certificate that specifies the amount of tax on a payment, or the rate of tax applying to the payment.

24N Special tax rate certificates for schedular payments

(1) The Commissioner may provide a person who is entitled to receive a schedular payment with a special tax rate certificate setting out the amount of tax for the payment, or the rate applying to the payment or a part of each payment as if it were the whole payment.

(2) Subsection (1) does not apply to a payment to a non-resident entertainer.

(3) The Commissioner may cancel a special tax rate certificate at any time. The Commissioner must give notice of the cancellation.

(4) If the Commissioner cancels a special tax rate certificate, the person who was provided the certificate must return it within 7 days of the date of notification of the cancellation.

(5) A special tax rate certificate must not be altered or be used to cause a person making a schedular payment not to withhold an amount of tax for the payment.

83. Section 141AA of the TAA provides for a specific shortfall penalty in respect of schedular payments that are contract payments to non-resident contractors where the non-resident contractor is not liable to pay tax on the payment, whether because of a DTA or otherwise.

141AA Shortfall penalty if non-resident contractor relieved from all liability to pay tax on contract payment

(1) If a person makes a schedular payment that is a contract payment to a person who is a non-resident contractor and the non-resident contractor is not liable to pay income tax on the contract payment, whether because of a double tax agreement or otherwise, the person who makes the contract payment to the non-resident contractor is liable to pay a shortfall penalty of $250 for each return period—

(a) for which the person is required to deliver to the Commissioner an employer monthly schedule; and

(b) in which the person fails to withhold an amount of tax that is required from a contract payment to the non-resident contractor.

(2) A person who is liable to pay a shortfall penalty under subsection (1) is not liable to pay a shortfall penalty based on the tax shortfall that, but for this section, would be calculated under section 141 in relation to the amount of tax required to be withheld.

(3) The liability under subsection (1) of a person is limited to a total of $1,000 for each return period for which the person is required to deliver to the Commissioner an employer monthly schedule.

Note: If section 141AA of the TAA does not apply in respect of the tax shortfall, then section 141 of the TAA will apply.

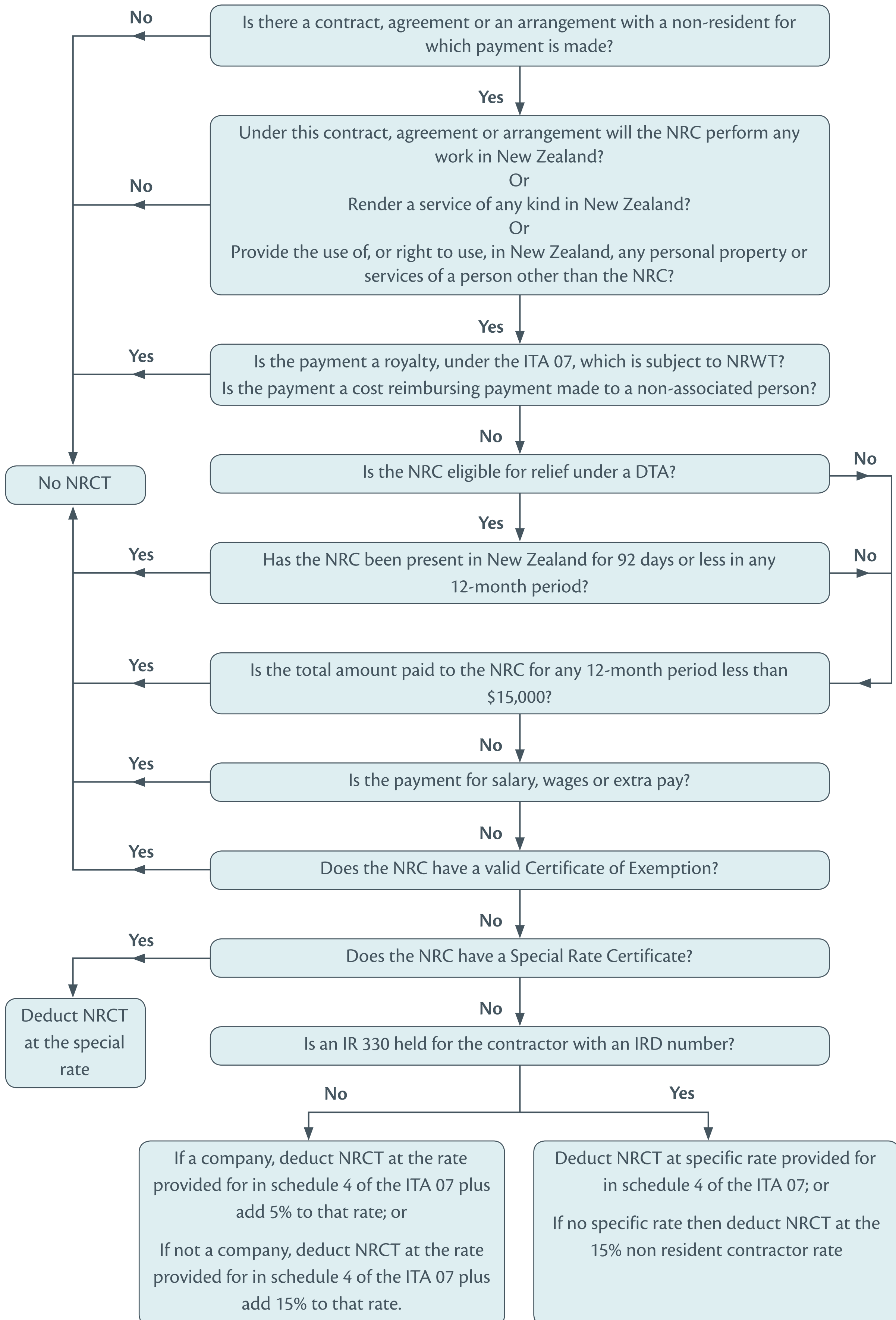
84. Section 168(1) of the TAA provides that in the case where tax has not been withheld, the tax owing constitutes a debt payable to the Commissioner by the payer of the PAYE income payment. Section 168(2) of the TAA provides that the Commissioner's right to recover the deficient tax from the payer is in addition to the right to recover from the recipient in accordance with the PAYE rules.

168 Employer or PAYE intermediary failing to withhold or deduct tax or payments

(1) Where an employer fails to withhold or deduct an amount of tax or combined tax and earner-related payment in accordance with the employer's obligations under the PAYE rules and, where applicable, section 115 of the Accident Rehabilitation and Compensation Insurance Act 1992 or section 285 of the Accident Insurance Act 1998 or section 221 of the Injury Prevention, Rehabilitation, and Compensation Act 2001, the amount in respect of which default has been made shall constitute a debt payable by the employer to the Commissioner, and shall be deemed to have become due and payable to the Commissioner on the date on which under section RD 4 of the Income Tax Act 2007 the employer would have been required to pay to the Commissioner the tax or combined tax and earner-related payment.

(2) The right of the Commissioner to recover from the employer the amount in respect of which default has been made shall be in addition to any right of the Commissioner to recover that amount from the employee under the PAYE rules; and nothing in those rules shall be construed as preventing the Commissioner from taking such steps as the Commissioner thinks fit to recover that amount from the employer and from the employee concurrently, or from recovering that amount wholly from the employer or from the employee or partly from the employer and partly from the employee.

Appendix Two: Flowchart for considering whether a payment is a schedular payment and any applicable withholding rate



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.

STAY OF LIQUIDATION PENDING APPEAL OF COMPROMISE APPLICATION REFUSED

Case	Property Ventures Investments Ltd and Ors v CIR
Decision date	28 May 2010
Act(s)	Companies Act 1993
Keywords	Stay, liquidation, compromise

Summary

The taxpayer companies' applications to the Court of Appeal for a stay of the Commissioner's liquidation proceedings (pending an appeal of the High Court's refusal of their compromise applications) were dismissed.

Impact of decision

There are no particular implications for the Commissioner. The case turns on its own facts.

Facts

The applicant companies have goods and services tax (GST) debts. The GST debts arose after the applicants sold commercial properties and failed to pay the output tax. After the registered mortgages on the properties were settled the applicants paid the balance of the proceeds of the sales in payment of debts owed to related entities.

The Commissioner applied to liquidate the applicants. The applicants responded by applying to the High Court under section 236 of the Companies Act for approval of compromises of their tax debts. The effect of the compromise proposals was that the Commissioner would be paid $1 million of a $2.4 million debt over a period of five years.

The Commissioner successfully opposed the section 236 compromise applications. The applicants applied to the High Court for a stay of the liquidation proceedings pending an appeal. The High Court refused the stay application.

The applicants then made a further application to the Court of Appeal for a stay of the liquidation proceedings pending an appeal of their section 236 applications.

Decision

After setting out a non-exhaustive list of factors to be taken into account in making its decision, the Court refused the applications for a stay. The Court had serious doubts about the bona fides of the applicants in pursuing the appeal. The Court noted that the applicants had not provided an explanation for paying the GST away for their own purposes.

The Court considered that there was a strong public interest in having an independent enquiry into the affairs of the applicant companies, sooner rather than later.

The Court considered that the merits of the compromise applications were weak and had little prospects of success.

As well, the Court took into consideration that the applicant companies did not have positions to preserve. None of them were trading, none had any employees and all appeared to be insolvent.

JUDICIAL REVIEW OF ASSESSMENTS REFUSED

Case	Tannadyce Investments Ltd v CIR
Decision date	4 June 2010
Act(s)	Companies Act 1993, Judicature Amendment Act 1972
Keywords	Assessments, judicial review, conscious maladministration, abuse of process

Summary

The Commissioner successfully appealed against the refusal of the High Court to strike out the taxpayer's judicial review claim in respect of certain assessments. The conscious maladministration complained of by the taxpayer was not found and did not affect the validity of the assessments.

Impact of decision

This case confirms that judicial review of assessments is only available in exceptional circumstances. Conscious maladministration is a possible exceptional circumstance that allows judicial review but it must be such that it invalidates the assessments made.

Facts

Two appeals were heard together. The first was an appeal by the taxpayer against a decision of an associate judge to dismiss its application to set aside the Commissioner's statutory demand. The second was an appeal by the Commissioner against the refusal of the High Court to strike out the taxpayer's judicial review claim as disclosing no reasonable cause of action and as an abuse of process.

The statutory demand was attacked on the basis that the Commissioner's default assessments were wrong and that the taxpayer had filed judicial review proceedings to have those assessments quashed. The central allegation in the judicial review of the assessments was that the Commissioner was knowingly in possession of taxpayer documents that he had repeatedly and falsely denied possessing and which the taxpayer required in order to file its tax returns.

Decision

The Court applied its decision in *Westpac Banking Corporation v CIR* [2009] NZCA 24. The Court held that as a general rule, the proper process for challenging tax assessments is contained in Part 8A of the Tax Administration Act 1994. Judicial review of assessments is permitted only in exceptional circumstances and may be available in cases of conscious maladministration. Where there are no such exceptional circumstances judicial review proceedings may be an abuse of process.

The Court held that in order to succeed on the ground of conscious maladministration there must be behaviour sufficiently egregious as to invalidate an assessment. The act complained of in this case was that the Commissioner had failed to disclose to the taxpayer certain documents, not that the Commissioner had failed to take them into account in making his assessment. There was no basis on which it could be said that the officer that made the assessments did not honestly believe that the assessments reflected the taxpayer's true liability.

The Court concluded that the allegations as pleaded did not come within the Westpac test for exceptional circumstances. The Commissioner's appeal was allowed and the judicial review proceedings were held to be an abuse of process and were struck out.

That finding meant that the taxpayer could not dispute the amount in Part 8A proceedings because the time limit had elapsed. There was therefore no arguable basis to dispute the sum claimed in the statutory demand. Accordingly the taxpayer's appeal against the decision to refuse to set aside the statutory demand was also dismissed.

INCOME SPLITTING RULED BY COURT OF APPEAL AS TAX AVOIDANCE

Case	Penny and Hooper v CIR
Decision date	4 June 2010
Act(s)	Income Tax Act 1994
Keywords	Derivation of income, tax avoidance arrangement, artificiality and contrivance

Summary

The Court of Appeal by majority ruled that income derived by the companies controlled by the taxpayers was substantially earned through the personal exertions of the taxpayers themselves. Therefore, when looked at objectively, remuneration for tax purposes needed to reflect the correct amount expected to be earned from the skills provided to the company.

Impact of decision

The decision is now the leading case on income splitting and has generated much media comment and some industry controversy. The decision follows on from other post *Ben Nevis* cases and confirms that the entire factual matrix is important when looking at key factors indicating a tax avoidance arrangement. In particular the artificiality and contrivance aspect of an arrangement will be very fact dependent and needs to be approached on a case by case basis. For more information see the Commissioner's Revenue Alert RA 10/01.

Facts

The two plaintiffs are orthopaedic surgeons. Each practices in both the public and private sector. Initially each practiced on their own account but after a period, each incorporated their practice. Each surgeon was then employed by their company to undertake the services they were undertaking as sole practitioners.

Mr Hooper began practicing in the private sector in 1989. The practice operated from a shared Orthopaedic Centre. In 1991 Mr Hooper and his wife were settlors of two "mirror trusts". The Trustees of both trusts were the solicitor and

the accountant. The beneficiaries were the spouse, children and grandchildren. The trusts were established to buy a share of the premises occupied by Mr Hooper. In 2000 the practice arrangement was "restructured" and Hooper Orthopaedic Limited (HOL) was formed. The family trusts owned 495 shares each while Mr and Mrs Hooper owned 5 shares each. Mr Hooper was the sole company director. Mr Hooper sold his practice to HOL for $332,473 including goodwill of $330,000.

HOL employed Mr Hooper for a salary of $119,990 between 2001 and 2003. He was the sole orthopaedic surgeon employed by HOL and as sole director he determined the salary. Patient referral was to Mr Hooper personally. HOL received patient fees as income. In 2001 HOL derived $593,914 from patient fees. In 2002 the income derived was $447,915 and in 2003 the amount was $502,882. During the years the trusts received fully imputed dividends from HOL.

Mr Penny commenced practice as a private orthopaedic specialist in 1991. In 1997 he incorporated Penny Orthopaedic Services Limited (POS) of which he was the sole shareholder. He also set up Orthopaedic Surgical Consulting Limited (OSCL) and A C Penny Trust No 1 (The Trust). All shares in POS were owned by the Trust. The trustees of the Trust were the accountant and the solicitor. Final beneficiaries of the Trust were Mr Penny, his wife their children and grandchildren. The premises from which Mr Penny worked were initially leased by Mr Penny to POS and were later sold to the Trust. His orthopaedic practice was transferred to POS in February 1997 for $144,310 which included goodwill of $100,000. In April 1997, OSCL purchased the surgical and medical practice from POS for $1,044,310. Goodwill in that transaction was $1,000,000. After the restructuring OSCL became Mr Penny's employer. OSCL received the patient fees as income. In the year 2001 OSCL had an income of $484,779, in 2002 the income was $609,871 and in 2003 it was $566,183. In each of those three years Mr Penny set his salary at $99,996.

The Commissioner issued notices of proposed adjustments (NOPAs) to both parties for the 2002, 2003 and 2004 years. The proposal by the Commissioner was to assess the salaries at a level which was considered to be a "commercially realistic salary". The tax in issue was the difference between the company rate of 33% and the individual earner rate of 39%. Adjudications found that section BG 1 of the Income Tax Act 1994 applied. The taxpayer(s) commenced proceedings in the High Court after the Commissioner issued assessments. The High Court found for the taxpayers in a decision reported as *Penny v CIR; Hooper v CIR* (2009) 24 NZTC 23,406. The Commissioner appealed to the Court of Appeal

Decision

Randerson J found that a tax avoidance arrangement did exist. Three separate written decisions were delivered by the Court. Randerson and Hammond JJ found for the Commissioner, Ellen France J dissenting. Only Randerson J's decision is reported here.

His Honour used the recent findings of the Supreme Court in *Ben Nevis Forestry Ventures Limited v CIR* and *Glenharrow Holdings Limited v CIR* as a basis for his interpretation of section BG1. At paragraph [63] he referred to paragraphs [102] and [103] of *Ben Nevis* and said the Supreme Court decided that:

> (a) the reconciliation of specific and general anti-avoidance provisions requires a "principled approach which gives proper overall effect to statutory language that expresses different legislative policies";
>
> (b) decisions on individual cases are to be made through "the application of a process of statutory construction focussing objectively on features of the arrangement involved, without being distracted by intuitive subjective impressions of the morality of what tax advisers have set up";
>
> (c) the specific tax provisions and the general anti-avoidance provisions are to be construed together so as to give appropriate effect to each; and
>
> (d) whether an arrangement constitutes tax avoidance will depend on whether the taxpayer's use of the specific statutory provision has occurred in a manner that is consistent with Parliament's purpose, determined by an objective analysis of the overall scheme and purpose of the Act.

He noted that the principles were expanded upon in paragraphs [102]–[109] of the *Ben Nevis* decision and particularly noted:

> [65] Of particular relevance to the present case are the observations made by the Supreme Court to the effect that:
>
> (a) the manner in which the arrangement is carried out will often be an important consideration;
>
> (b) so too, the role of the relevant parties and any relationship they may have with the taxpayer;
>
> (c) the economic and commercial effect of transactions may be significant; and
>
> (d) a classic indicator of a use that is outside parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provisions "in an artificial and contrived way".

In paragraph [66] Randerson J endorsed what the Supreme Court said in paragraph [40] of *Glenharrow* about looking at the "aim or end in view" of an arrangement. The arrangement needing to be objectively assessed and noting from paragraph [40] that "The purpose of an arrangement

will be deduced from the arrangement itself and its effect …".

When discussing the "nature and scope of the arrangement alleged" he noted at paragraph [70] of his judgment that "the expression 'arrangement' is very broadly defined". The essential elements relied upon by the Commissioner as constituting a tax avoidance arrangement were:

(a) the decision of the taxpayers in the relevant income years to operate their private practices through the company and family trust structure;

(b) the decision by the relevant companies and the individual taxpayers to pay the respondents a salary that was substantially less than a commercially realistic salary;

(c) channelling the company profits to the trust and allowing the taxpayers to have the benefit of those funds without deriving such funds as their personal income; and

(d) in Mr Penny's case the decision to advance funds to him from the trust.

Randerson J confirmed that an arrangement is not limited to "a specific transaction or agreement". At paragraph [78] he stated:

> [78] I am satisfied that an "arrangement" is not limited to a specific transaction or agreement but may embrace a series of decisions and steps taken which together evidence and constitute and agreement, plan or understanding. Any such arrangement may be continued in each of the income years in question or may be varied from year to year.

After defining what constituted an arrangement Randerson J then looked at "whether or not the arrangement directly or indirectly had tax avoidance as one of its purposes or effects?". He noted at paragraph [88] that in the absence of a general anti-avoidance provision the taxpayers were entitled to take advantage of the different applicable tax rates. Randerson J then asked "whether viewed in light of the arrangement as a whole, the taxpayer has used the specific provisions of the tax legislation to alter the incidence of income tax in a way that cannot have been within the contemplation of Parliament?". He then confirmed that the answer to the question involves looking at the "scheme and purpose of the Act".

While noting that Parliament introduced Personal Services Attribution ("PSA") rules at the same time as it increased the top rate for personal income tax, Randerson J did not accept that because Parliament addressed the prospect of tax avoidance in one set of circumstances, "… that it did not contemplate that the general tax avoidance provision might apply in other situations". At paragraph [94] he stated:

> [94] Moreover, as noted by the Supreme Court in *Ben Nevis*, one of the reasons for the general anti-avoidance provisions being expressed in broad terms, is the difficulty in predicting in advance the ingenuity of taxpayers in adapting the forms in which they do business.

The significance of *Hadlee v CIR* was discussed in paragraphs [101] to [109]. Randerson J accepted that the case was different in so much as *Hadlee* did not relate to a company which was deriving the income. The diversion of the income generated from personal exertion was however seen as significant when undertaken in "a way which undermines the graduated personal tax regime …".

In conclusion Randerson J noted at paragraph [110] that:

> [110] The Supreme Court has made it clear in *Ben Nevis* that the adoption of legitimate legal structures or entities will not be a barrier to a finding of tax avoidance if the arrangements are artificial, contrived, or amount to a pretence. Findings of that character will be influenced by assessing them in the light of commercial reality and the economic effect of the arrangements. The conclusion of the Supreme Court in this respect is supported by a substantial body of precedent both in this court and the Privy Council.

The arrangements not only had the effect of altering the incidence of income tax but the alteration was at least one of the purposes of the arrangement. His Honour found that the purpose or effect of altering the incidence of tax was not merely an incidental purpose or effect [paragraph 112]. He noted that there was nothing wrong with the change to the use of the company structure. However, he thought it significant that each had previously practiced on their own account and the net income of each dropped significantly after the introduction of the top personal tax rate.

It was also noted that both Mr Penny and Mr Hooper had agreed that their salaries were at levels substantially below what they would have expected had they been employed independently and at arm's length [paragraph 113–114]. Consideration was also given to the fact that the personal exertions of Mr Penny and Hooper were the same as before and that company profits increased. The surplus company profits were then transferred to Mr Penny and Mr Hooper and their families. While accepting that there may have been a secondary purpose or effect for making the arrangements, Randerson J also mentions that any enhanced personal income, after tax, could also have been applied for the benefit of the surgeons and their families [paragraph 120].

At paragraph [122], Randerson J confirmed that when the overall circumstances were taken into account, the avoidance of tax was more than a merely incidental purpose or effect of the arrangement. He noted that the salaries adopted were so far removed from commercial reality as to be "contrived and artificial". He also noted that the case had some parallels with *Hadlee*. The amount of goodwill paid by the companies for the services of the surgeons was another factor Randerson J saw as relevant in regards to the "artificiality" of the arrangements [paragraph 124].

Randerson J finished by acknowledging the consequences of the decision, he stated:

> [125] I am conscious of the practical consequences which may flow from this decision, including the uncertainty which may be created for the Commissioner as well as for taxpayers and their advisers. To what extent and in what circumstances will it be necessary to review the salary levels of employees (particularly in family companies) to determine on which side of the line their salary may fall? It is important to recognise however, **that this decision should not be regarded as establishing a principle that salary levels in family companies which are below the levels which could be expected in an arms-length situation, are necessarily to be regarded, without more, as evidence of a tax avoidance arrangement.**
>
> (Emphasis added)

CONTRACTOR NOT A PARTY TO A SHAM

Case	TRA No. 029/08
Decision date	16 June 2010 (interim decision only)
Act(s)	Tax Administration Act 1994, Income Tax Acts 2004 and 2007, Goods and Services Tax Act 1985, and Income Tax (Withholding Payments) Regulations 1979
Keywords	Sham, false invoices, deductibility, agent

Summary

Judge Barber held that the disputant was not claiming income tax deductions (or GST inputs) in respect of invoices knowing them to be false. His Honour allowed leave for the parties to make submissions on the legal issue of deductibility (including whether GST inputs can be based on false invoices). However, he considered that the false invoices were costs incurred by the disputant in good faith in seeking to derive assessable income so that they are deductible in the usual way.

Impact of decision

This decision is limited to its facts.

Facts

The disputant (an orchardist and contracting company) challenged the Commissioner's reassessments of its GST, PAYE and income tax for 2006 and 2007.

The Commissioner alleged that the disputant had used false invoices from subcontractors to claim income tax deductions, GST inputs and to avoid paying PAYE on salaries paid in cash.

It was accepted by the disputant that five of its subcontractors were involved in a fraudulent invoice writing scheme. However, the disputant claimed that one of its ex-employees was running a secret and separate business operation using the invoice writing companies without the disputant's knowledge.

The Commissioner alleged that the disputant (via its proprietor Mr J) was well aware of its involvement in the fraudulent invoice writing scheme and was attempting to use its ex-employee as a scapegoat.

Decision

Judge Barber held that he could not be satisfied, on the balance of probabilities, that the disputant (through its proprietor Mr J) knew that the invoices upon which the disputant had claimed income tax deductions and GST inputs were false. In terms of the reasoning of Richardson J in *NZI Bank v Euro-National Corporation Ltd*, Judge Barber held that because the invoices were not a sham to which the disputant was a party, the legal effect of the invoices was to be respected.

The Commissioner argued that Mr J had actual knowledge of the sham and was the directing mind of the disputant. A principal is not bound by an agent's knowledge of fraud; but where a person who may properly be classified as the "directing mind of the company" has actual knowledge, the principal company will be liable: *El Ajou v Dollar Land Holdings Plc* [1994] 2 ER 685. His Honour held that the level of proof led for the Commissioner was insufficient for him to find as a fact that Mr J was a knowing participant in the "fraudulent invoice writing scam".

His Honour considered that the disputant had paid out on invoices which it believed were genuine because its proprietor Mr J was duped by an ex-employee. His Honour considered this to be expenditure incurred in the course of the disputant's business even though some of the invoices were false. His Honour allowed leave for the parties to make submissions on the legal issue of deductibility (including, whether GST inputs can be based on false invoices). Nevertheless, His Honour considered that the false invoices are costs incurred by the disputant in good faith in seeking to derive assessable income so that they are deductible in the usual way.

His Honour was uncertain whether the Commissioner still relied on his first ground for disallowing the income tax deductions, GST inputs and for increasing PAYE as being due to insufficient documentation and information. His Honour said that he would reconvene the hearing on that aspect if necessary however, his view was that there was sufficient documentation and information to comply with the discretions available to the Commissioner.

DISCOVERY RIGHTS REMAIN NOTWITHSTANDING THE EVIDENCE EXCLUSION RULE

Case	Radio Works Ltd, TV Works Ltd v CIR
Decision date	18 June 2010
Act(s)	Tax Administration Act 1994, High Court Rules
Keywords	Discovery, section 17 notices, evidence exclusion rule

Summary

The applicant sought a review of the decision of Associate Judge Abbott who ordered discovery in a challenge of the Commissioner's assessments. The High Court declined to overturn the orders noting that the Commissioner notwithstanding various disputes process provisions in the Tax Administration Act 1994 ("TAA") is as entitled to discovery as any other litigant.

Impact of decision

The Court confirmed the "sea change" in tax litigation and discovery *(BNZ Investments)* and the compatibility of the Commissioner's investigative powers with his right to discovery. The court confirmed that section 138G should be read together with section 89M which only requires an "outline" of evidence to be relied on. Thus documents obtained later in the course of discovery are not excluded by this rule.

Facts

The plaintiffs, Radio Works Ltd and TVWorks Ltd, are challenging assessments made by the Commissioner disallowing deductions claimed in relation to optional convertible notes (OCNs) issued by the plaintiffs to other companies in the same group. The Commissioner wishes to obtain general discovery from the plaintiffs and discovery from a non party, MediaWorks NZ Ltd, which is the plaintiffs' parent company. Associate Judge Abbott dismissed applications by the plaintiffs for orders that general discovery not be required and granted the Commissioner's application for particular discovery against MediaWorks NZ Ltd. The plaintiffs and MediaWorks NZ Ltd applied to review the Associate Judge's decision.

Decision

The plaintiffs' general proposition was that, although general discovery is not precluded in tax cases, it will only be appropriate in rare cases. This is because the purpose and effect of the statutory scheme in the TAA is to ensure that the Commissioner has the power to obtain all relevant documents and information prior to making an assessment. In most cases, therefore, the Commissioner will already have all relevant documents, making it inappropriate to put the taxpayer to the expense of formal discovery.

MediaWorks NZ Ltd argued that the Associate Judge erred by holding that the evidence exclusion rule in section 138G of the TAA did not require the parties to set out all the available documentary evidence in their statements of position but merely precluded them from asserting "wholly new facts" and, as a result, wrongly concluded that the documents sought on discovery fell within the parties' statements of position and were arguably not excluded by section 138G.

Her Honour Justice Courtney reviewed the history of Part IVA, of the TAA, and its connection with the evidence exclusion rule in Part VIIIA. She did not find that there was any presumption against discovery in that analysis:

> I do not find the materials that Mr McKay relied on helpful in determining the availability of discovery in tax cases. They were not relied on by the Court of Appeal in *BNZ Investments v Commissioner of Inland Revenue* [2008] 1 NZLR 598, 619, where the Court accepted that there had been a "sea-change" in tax litigation over the preceding 15–20 years (at [19]).

Her Honour noted that disclosure under section 17 compared with discovery had been considered recently by the Court of Appeal in *ANZ National Bank Limited v Commissioner of Inland Revenue* [2009] 3 NZLR 123 where it was clearly held that the ambit of section 17 and that of discovery are quite different. Section 17 applies to documents directly relevant to an investigation, whereas discovery is based upon far broader principles as enunciated in the *Peruvian Guano* case (1883) 11 QBD 55 (CA). This is particularly so where the Commissioner seeks information from third parties.

At [33] Her Honour summarised her findings on the section 17 point:

> Three significant points emerge from these cases. First, because the discovery process is wider than the disclosure process under the TAA, discovery could result in the disclosure of documents that would not be required to be disclosed under s 17. Secondly, there is no reason to treat the Commissioner differently from other litigants, including in relation to the discovery process. Thirdly, the Commissioner should not be precluded from discovery because he did not make ongoing attempts to obtain further disclosure under s 17.

Regarding the operation of section 138G, rather than favour an exclusive "all cards on the table" approach, Her Honour preferred an analysis which aligned the scope of 138G with that set out in the section which sets the evidential standard; section 89M(4)(b) and (6)(b) simply requires "an outline of the evidence".

Regarding third party discovery, the plaintiffs contended that discovery was no longer relevant as they no longer intended to rely on the argument which precipitated the application.

> The concessions made by the plaintiffs may assist the Commissioner in advancing his argument. However, it seems to me artificial to expect the Commissioner (and the expert witnesses on both sides) to adequately address the question of the value of these OCNs without a full understanding of the nature of the related party transactions of which they formed a part.

The essence of the decision is set out at paragraphs [75] and [76]:

> [75] I have concluded that discovery in tax litigation is not limited to rare cases. The ambit of disclosure under s 17 is narrower than the ambit of discovery under the High Court Rules by reason of the breadth of the *Peruvian Guano* test. The fact that the Commissioner might, by issuing further notices under s 17, have obtained more documents is no reason to refuse discovery. Nor, in the normal course, should the fact that parties may have expended substantial time and cost complying with s 17 notices preclude discovery being required in later proceedings.
>
> [76] In relation to the evidence exclusion rule in s 138G, I have concluded that this ought to be read together with s 89M(4)(b) and (6)(b) so that a party is required only to provide an outline of the evidence relied on rather than identifying each piece of evidence. As a result, documents obtained later during the course of discovery are not necessarily excluded by s 138G.

LEAVE TO ADDRESS CONSEQUENTIAL MATTERS IN A DECISION IS NOT A SUBSTITUTE FOR AN APPEAL

Case	TRA No. 03/03 decision [2010] NZTRA 09
Decision date	21 June 2010
Act(s)	Taxation Review Authorities Act 1994
Keywords	Leave reserved, appeal

Summary

The scope of leave reserved to address matters arising as a consequence of a judgment is not a substitute for an appeal from that judgment.

Impact of decision

While a short ruling, the decision is authority for the proposition that the general leave reserved provision is not a substitute for actual appeal, or ancillary to appeal, or an opportunity to litigate substantive issues again or in addition to the substantive case. It is firmly confined to "consequential matters".

Facts

At the conclusion of the substantive hearing (reported as *Case Z19* (2009) 24 NZTC 14,219) the Taxation Review Authority ("TRA") reserved leave to apply to the TRA on consequential matters from the substantive decision (for a specific time period).

The Disputant, purporting to rely upon the leave, raised three issues with the TRA all of which were subject to appeal to the High Court. Those issues were:

a) the application of the *BASF* principle to the decision as a consequence of the earlier *Case W8* (2003) 21 NZTC 11,063. The substantive decision concluded the *BASF* principle didn't apply due to the invalidity of *Case W8*;

b) the lack of an alternative tax avoidance reconstruction put forward by the Disputant. The substantive decision did address the reconstruction and concluded the Disputant had not shown the Commissioner's reconstruction was wrong (at par 276–278 of *Case Z19*); and

c) the application of section 99(4) was at variance with other higher authority and/or dicta.

The Commissioner pointed out that all these issues were subject to appeal by the disputant.

Decision

Judge Barber concluded that none of the issues raised by the Disputant fell within the leave granted.

His Honour concluded that where the issue is also the subject of an appeal then it is simply not something to be dealt with under the leave granted (paragraphs [7], [9] and [11]).

In general the Judge concluded that it is not appropriate to endeavour to raise further substantive argument, under the leave reserved provision.

TAXPAYER FAILS IN ATTEMPT TO RE-LITIGATE CLAIM

Case	Clarence John Faloon and Ors v CIR
Decision date	11 June 2010
Act(s)	High Court Rules
Keywords	Strike out, previously unsuccessful litigation

Summary

The taxpayer had a claim in the High Court struck out due to having previously failed in the Court on the same issue. An attempt to have the strike-out reviewed failed.

Impact of decision

The decision is a reminder of the need to follow court rules and guidelines. It reaffirms that an application for a review of a judgment of an Associate Judge by a High Court Judge will need to be based on sound merits. Absent these merits, the Court will not lightly allow matters to be revisited under the guise of procedural mechanisms.

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 is compensation owing on assets which were once owned by the companies. The compensation relates 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 for loss of patent rights which were owned by one of the companies.

On 29 April 2010, at the High Court in Rotorua, Associate Judge Christiansen found against Mr Faloon and struck out his claim against the Commissioner. The claim related to attempts of Mr Faloon to have the Commissioner assess income to a trust he had established. The income was allegedly from compensation he claimed was due to the trust but it related to the land owned by the companies. Compensation had already been received by the companies which have since been liquidated.

The claim was struck out because Mr Faloon had previously been unsuccessful when litigating the same issue against the Commissioner.

Mr Faloon applied on 3 May 2010 for an "Interlocutory application for orders to set aside the judgment delivered on 29 April 2010 which does not comply with the High Court Rules". On 6 May 2010, he made an "Amended Interlocutory Application by three Plaintiffs under rule 2.3 to review all the orders or decisions made by His Honour Associate Judge Christiansen".

Mr Faloon did not comply with Rule 2.3(2) of the High Court Rules which specified that an application for review of the decision of an Associate Judge must be **filed and served** within five working days of the decision being given.

Decision

Justice Woodhouse firstly considered the 3 May application. He concluded that the matter was at an end principally because the issue had been dealt with by Associate Judge Christiansen. In addition he was satisfied that the application did not raise any issue distinct from an issue that might be raised on an application for review of, or appeal against, Associate Judge Christiansen's decision (paragraphs [5] and [6]).

It was noted that service did not take place until 28 May 2010. Justice Woodhouse said an extension of time may be granted if "the delay was not extensive, there was an adequate explanation for the delay, there is no material prejudice to the other party and there is merit in the application".

Justice Woodhouse then found that "there was no adequate explanation for the delay". He also noted that there was "no merit in the application". Furthermore, he saw the decision of Associate Judge Christiansen as a "careful judgment providing compelling reason for the judgment to be struck out" (paragraph [11]).

Justice Woodhouse considered that Mr Faloon was attempting to re-litigate matters which have been before the High Court and Court of Appeal in different forms over a number of years and accordingly His Honour did not allow an extension of time.

The matter is no longer a live issue before the court, costs of $750 were awarded to the Commissioner.

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 10/01: RECORDING INLAND REVENUE INTERVIEWS

Introduction

1. For the purpose of administering the Inland Revenue Acts[1] it is often necessary for Inland Revenue officers to conduct interviews with taxpayers and others. The purpose of an interview will range from general information exchanges to resolve queries to formal interviews where there is the potential for litigation.
2. Interviewees will generally be asked to attend an interview on a voluntary basis. However, section 19 of the Tax Administration Act 1994 gives the Commissioner the authority to require any person to attend an interview. Compulsory interviews under section 19 are held when considered appropriate by the Commissioner to obtain information from taxpayers or other parties.
3. As statements made by taxpayers and others during an interview may be admissible as evidence in litigation it is important that all interviews are carried out in a fair and open manner and in a way that will not make the statement inadmissible. It is also important that interviews are clearly recorded and that the questions and answers are unambiguous.
4. Not all interviews conducted by Inland Revenue will be electronically recorded. In many cases traditional hand-written notes will be sufficient. However, Inland Revenue is increasingly conducting interviews using technology.
5. This Standard Practice Statement (SPS) sets out Inland Revenue's standard practice for using technology to record interviews where it is appropriate.
6. Unless specified otherwise, all legislative references in this SPS refer to the Tax Administration Act 1994 ("the TAA").

Application

7. This SPS applies from 1 July 2010. It replaces SPS INV-330 *Tape-recording Inland Revenue interviews* which was published in *Tax Information Bulletin* Vol 12, No 5 (May 2000).
8. It does not apply to independent contractors conducting interviews on behalf of Inland Revenue, such as a research company contracted to carry out a customer survey, or an external solicitor contracted to carry out a Child Support Review.

[1] As set out in the Schedule to the Tax Administration Act 1994.

Legislation

9. Section 19 of the TAA provides:

> **19 Inquiry by Commissioner**
>
> (1) The Commissioner may, for the purpose of obtaining any information with respect to the liability of any person for any tax or duty under any of the Inland Revenue Acts or any other information required for the purposes of the administration or enforcement of any of those Acts or for the purpose of carrying out any other function lawfully conferred on the Commissioner, by notice, require any person to attend and give evidence before the Commissioner or before any officer of the Department authorised by the Commissioner in that behalf, and to produce all books and documents in the custody or under the control of that person which contain or which the Commissioner or the authorised officer considers likely to contain any such information.
>
> (2) The Commissioner may require any such evidence to be given on oath and either orally or in writing, and for that purpose the Commissioner or the authorised officer may administer an oath.
>
> (3) No person summoned or examined under this section shall be excused from answering any question on the ground that the answer may incriminate the person or render the person liable to any penalty or forfeiture.
>
> (4) No statement made by any such person in answer to any question put to the person shall in criminal proceedings be admissible against the person, except upon a charge of perjury against the person in respect of the person's testimony upon that examination.
>
> (5) The provisions of the Crimes Act 1961 which relate to perjury are applicable to any inquiry under this section.
>
> (6) A person required to attend before the Commissioner or an authorised officer may receive out of money appropriated by Parliament for the purpose such sum on account of travelling expenses and loss of time as the Commissioner thinks reasonable and orders accordingly.

10. Principle 6 of the Privacy Act 1993 provides:

> **Principle 6 Access to personal information**
>
> (1) Where an agency holds personal information in such a way that it can readily be retrieved, the individual concerned shall be entitled—

(a) To obtain from the agency confirmation of whether or not the agency holds such personal information; and

(b) To have access to that information.

(2) Where, in accordance with subclause (1)(b) of this principle, an individual is given access to personal information, the individual shall be advised that, under principle 7, the individual may request the correction of that information.

(3) The application of this principle is subject to the provisions of Parts 4 and 5 of this Act.

11. Section 27 of the Privacy Act 1993 provides for exceptions to Principle 6, one of which may sometimes apply to Inland Revenue responsibilities for administering the Revenue Acts

(1) An agency may refuse to disclose any information requested pursuant to principle 6 if the disclosure of the information would be likely—

…

(c) To prejudice the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial; …

Standard practice

12. The electronic recording of interviews is common practice by regulatory and investigative agencies. There are advantages for both parties in electronically recording interviews:

- Using technology to record an interview will take less time than taking hand-written notes;
- Electronic recording provides an exact record of what was said by all the parties at the interview;
- Those parties at the interview are able to concentrate fully on the interview instead of there being delays while taking full written notes;
- An electronic copy of the interview will, in most cases, be made available to the interviewee.

13. It is likely that electronic recording would be necessary where:

- the tax affairs which the interview relates to are complex;
- there are numerous facts to be gathered;
- there are inconsistencies in the interviewee's explanations to date;
- the relationship between the interviewee and Inland Revenue has deteriorated and objectivity needs to be restored;
- there is a possibility that Inland Revenue may commence civil or criminal proceedings.

These are examples only and the decision by Inland Revenue staff to record an interview is not limited to these situations.

14. An interviewee may request that an interview be recorded. Such requests should be made before the interview in sufficient time to arrange recording equipment.

Preliminary matters

15. If Inland Revenue intends to electronically record an interview, the interviewee will be advised of that intention when the interview is arranged.

16. If a decision about electronically recording an interview subsequently changes, the interviewee is to be advised of that decision as soon as practicable before the interview starts.

17. Where an interviewee is attending an interview voluntarily the interview will only be electronically recorded with the interviewee's consent and cooperation. If the interviewee declines to consent to recording of a voluntary interview, Inland Revenue will respect that decision. There will be no secret recording of interviews.

18. Compulsory interviews under section 19 will always be electronically recorded, using video recording technology in appropriate cases. The interviewee's consent is not required for electronically recording section 19 interviews.

The recording process

19. There are three ways in which an interview may be recorded:

a) in handwriting (which may be typewritten later);

b) by audio recording;

c) by video recording.

20. As noted, it is preferable to record interviews using technology rather than taking hand-written notes. Video recording is not regularly used but may be used when it is appropriate, such as when the interview is likely to be used evidentially.

21. Hand-written notes may be taken even when an interview is being recorded electronically.

The interview

22. After the formal introduction to the interview, the interviewer will ask the interviewee to acknowledge that the interview is being electronically recorded (and in the case of a voluntary interview, with the consent of the interviewee).

23. The interview may be admitted in evidence. To avoid any misunderstanding, it is important that everyone involved in the interview speaks clearly and slowly.

24. If more than one interviewer is asking questions, they will need to identify themselves for purposes of transcription.

Copies

25. The purpose of an interview is to obtain information to assist in fulfilling the Commissioner's duties. For this reason copies of interviews are kept for reference and for use in potential litigation.
26. Under Principle 6 of Privacy Act 1993[2] a person is entitled to ask for a copy of any material that relates to them held by, for example, a government agency or an employer.
27. **Hand-written interview notes:** If the result of an interview is recorded in writing, the statement will be read back to the interviewee, or the interviewee should be asked to read it. The interviewee will be asked to initial each page except the last, which should be signed with the interviewee's full name. If the handwriting is easily legible, it may not be necessary to have the record typed. If requested, the interviewer, in most cases, will give the interviewee a copy of the statement immediately. If copying facilities are not immediately available, a copy may be posted to the interviewee.
28. **Digitally recorded interviews:** If a digital recording system is used, the original recording on the hard drive of a laptop computer or hand-held recorder cannot be sealed but will be moved to a permanent and secure storage repository. The technology used by Inland Revenue creates tamper-proof recordings and these are transferred to permanent storage under strict controls to ensure future security of related records. The interviewee must be told this. In such cases the interviewer should immediately make copies to CD or DVD (depending on the technology available). One copy is to be sealed in the interviewee's presence. The other copy will become an Inland Revenue file copy.
29. **Copy of the interview record to the interviewee:** Inland Revenue will, in most cases, give the interviewee a copy of a recorded interview. However, in some cases there may be reason to suspect that giving an interviewee a copy may prejudice the maintenance of the law, which in Inland Revenue's case means the administration of the Inland Revenue Acts.
30. In cases such as these, the Privacy Act 1993 and the Official Information Act 1992 allow the agency to withhold copies until the investigation has been completed.
31. Where it is decided not to provide a copy immediately, an interviewee will be told of the decision to withhold that copy, and that one will be supplied at the conclusion of the investigation. The interviewee will be advised of their right under section 67 of the Privacy Act 1993 to seek an investigation and review by the Privacy Commissioner of the Commissioner's decision to withhold the copy.

This Standard Practice Statement is signed on the 30th of June 2010.

Rob Wells

LTS Manager, Technical Standards

[2] Privacy Act 1993. There is a similar provision in section 5 of the Official Information Act 1992 (the "Principle of Availability").

SPS 10/02: IMAGING OF ELECTRONIC STORAGE MEDIA

Introduction

1. Taxpayers record and store business records and other information on a variety of electronic storage media. This Standard Practice Statement (SPS) sets out Inland Revenue's practice when taking an image of a taxpayer's electronic storage media. This SPS has been produced to establish Inland Revenue's standards for imaging electronic storage media and to ensure that Inland Revenue performs that function efficiently, effectively and consistently.
2. All references to legislation in this SPS are to the Tax Administration Act 1994 ("TAA") unless specified otherwise.

Application

3. This SPS discusses a small part of Inland Revenue's wider information-gathering powers under the TAA. The standard practice contained in this SPS will be applied where other means of obtaining information are inappropriate or inadequate.
4. This SPS applies from 14 July 2010.

Background

5. Electronic record-keeping and the storage of information by electronic means has become common practice for taxpayers. Technological developments mean records can be kept and information can be stored electronically on a variety of media.
6. Information stored electronically falls within the definition of "book and document" under section 3. Examples include, but are not limited to, information stored in computer hard drives, USB flash drives, mobile phones, personal digital assistants, photocopiers, scanners, and external hard drives. The Commissioner is entitled to access such information where it is "necessary or relevant" under section 16.
7. Consequently, there is a need for Inland Revenue to expand its information collection methods to accommodate technological advances. This SPS provides the framework within which an electronic storage medium can be imaged using the existing statutory information gathering powers provided for in sections 16 and 16B.
8. The imaging of the electronic storage medium is generally performed on-site where the medium is located. If this is not possible, section 16B allows the Commissioner to remove the device to image off-site. In certain circumstances, section 16C provides that the Commissioner can, by obtaining a warrant or with the consent of the occupier, remove and retain the electronic storage medium to allow full and complete inspection. However, note that the scope of this SPS is limited to the imaging of electronic storage media only. It does not extend to the retention of electronic storage media for inspection.

Definitions

9. The following terms are used throughout this SPS:

   Electronic storage medium: Any device that has the ability to store data electronically. This may include computer hard drives, memory cards, memory sticks, mobile phones, MP3 players, or any other devices that have the function of storing data electronically.

   Image: An exact copy of all data from the original electronic storage medium, saved in a file format that is evidentially sound and allows retrieval and analysis of that data.

Summary

10. Section 16 authorises the Commissioner to have full and free access to any place to inspect and copy all books and documents that the Commissioner considers necessary or relevant for a purpose under an Inland Revenue Act.
11. The definition of "book and document" in section 3 includes an electronic storage medium.
12. Generally, as a starting point, a relevance search will be carried out on the electronic storage medium in order to satisfy the Commissioner that the electronic storage medium contains "necessary or relevant" information or it is likely to provide any information otherwise required. However, there may be circumstances where the Commissioner has sufficient information to be satisfied that the electronic storage medium contains information that is "necessary or relevant" without conducting a relevance search.
13. In some cases, such as where the data stored on the electronic storage medium is encrypted or where there has been a claim of legal privilege or non-disclosure right, it may not be practicable for the Commissioner to conduct a relevance search. In which case the medium will be imaged without carrying out a relevance search. This does not necessarily mean that the search is unreasonable in terms of section 21 of the New Zealand Bill of Rights Act 1990 because there may be circumstances where the Commissioner has sufficient information to be satisfied that the electronic

storage medium contains information that is "necessary or relevant" without conducting a relevance search.

14. As the courts have found that an electronic storage medium is analogous to a book or a very long document, the entire electronic storage medium will be imaged if the relevance search identifies information that is "necessary or relevant".
15. In the event that a claim of legal privilege or non-disclosure right for tax advice documents is made, in order to preserve the information, the electronic storage medium will either be sealed, or imaged and then sealed.
16. The Commissioner will attempt to resolve the claim of legal privilege or non-disclosure right with the person making the claim by negotiation, although the matter may need to be resolved through the courts.
17. The imaging of the electronic storage medium is generally performed on-site where the electronic storage medium is located. However, under section 16B, the Commissioner may remove an electronic storage medium for the purpose of imaging it.
18. In deciding whether to remove an electronic storage medium, the Commissioner may consider the following:
    - Volume of data stored on the electronic storage medium;
    - Whether it is appropriate or practicable for the electronic storage medium to be removed;
    - The time it may take to image the electronic storage medium on-site;
    - The occupier's preference for the removal of the electronic storage medium or other reasonable alternatives as suggested by the occupier; and
    - Whether it is appropriate for the Inland Revenue officers to remain at the premises.

    In any case, if there are reasonable grounds to believe that there is a risk to the information stored on the electronic storage medium, the electronic storage medium will be removed.
19. Consent for the removal of the electronic storage medium for imaging is not required by section 16B.
20. To minimise any disruption to business that may be caused by the removal of the electronic storage medium, the owner has a right to inspect and obtain a copy of the electronic storage medium that is removed.
21. The scope of this SPS is limited to the standard practice for imaging electronic storage media. It does not extend to the power to remove and retain books or documents for inspection under section 16C.

Legislation

22. The relevant provisions in the Tax Administration Act 1994 in relation to the information gathering powers are sections 3, 16 and 16B:

Tax Administration Act 1994

3 INTERPRETATION

"Book and document", and **"book or document"**, include all books, accounts, rolls, records, registers, papers, and other documents and all photographic plates, microfilms, photostatic negatives, prints, tapes, discs, computer reels, perforated rolls, or any other type of record whatever:

16 COMMISSIONER MAY ACCESS PREMISES TO OBTAIN INFORMATION

16(1) Access of Commissioner or authorised officer Notwithstanding anything in any other Act, the Commissioner or any officer of the Department authorised by the Commissioner in that behalf shall at all times have full and free access to all lands, buildings, and places, and to all books and documents, whether in the custody or under the control of a public officer or a body corporate or any other person whatever, for the purpose of inspecting any books and documents and any property, process, or matter which the Commissioner or officer considers necessary or relevant for the purpose of collecting any tax or duty under any of the Inland Revenue Acts or for the purpose of carrying out any other function lawfully conferred on the Commissioner, or considers likely to provide any information otherwise required for the purposes of any of those Acts or any of those functions, and may, without fee or reward, make extracts from or copies of any such books or documents.

16(2) Assistance required The occupier of land, or a building or place, that is entered or proposed to be entered by the Commissioner, or by an authorised officer, must—

(a) Provide the Commissioner or the officer with all reasonable facilities and assistance for the effective exercise of powers under this section; and

(b) Answer all proper questions relating to the effective exercise of powers under this section, orally or, if required by the Commissioner or the officer, in writing, or by statutory declaration.

16(2A) Person may accompany Commissioner or authorised officer A person whom the Commissioner or an authorised officer considers necessary for the effective exercise of powers under this section may accompany the Commissioner or the authorised officer to a place.

16(3) Restricted entry to private dwelling Notwithstanding subsection (1), the Commissioner, an authorised officer, or a person accompanying the Commissioner or the authorised officer, shall not enter any private dwelling except with the consent of an occupier or pursuant to a warrant issued under subsection (4).

16(4) Warrant to enter private dwelling A judicial officer who, on written application made on oath, is satisfied that the exercise by the Commissioner or an authorised officer of his or her functions under this section requires physical access to a private dwelling may issue to the Commissioner or an authorised officer a warrant to enter that private dwelling.

16(5) Terms of warrant for entry Every warrant issued under subsection (4)—

(a) Shall be in a form prescribed by regulations made under this Act; and

(b) Shall specify an authorised officer of the Department, whether by name or in general, who may act under the warrant; and

(ba) Shall specify whether other persons may accompany the officer acting under the warrant; and

(c) Shall be valid for a period of 1 month from the date of its issue or such lesser period as the judicial officer considers appropriate; and

(d) Shall state its period of validity, or the date on which it expires.

16(6) Production of warrant and identification Every person exercising the power of entry conferred by a warrant issued under subsection (4) shall produce the warrant of authority and evidence of identity—

(a) On first entering the private dwelling; and

(b) Whenever subsequently reasonably required to do so.

16(7) Definitions In this section—

"Judicial officer" means any District Court Judge, justice, Community Magistrate, or Registrar of a District Court; but does not include any person who is an officer or employee of the Department:

"Private dwelling" means any building or part of a building occupied as residential accommodation (including any garage, shed, and other building used in connection therewith); and includes any business premises that are or are within a private dwelling.

16B POWER TO REMOVE AND COPY DOCUMENTS

16B(1) Removal of books or documents The Commissioner, or an officer of the Department authorised by the Commissioner, may remove books or documents accessed under section 16 to make copies.

16B(2) Return of books or documents Any copies of the books or documents removed must be made, and the books or documents returned, as soon as practicable.

16B(3) Certified copy admissible as evidence A copy of a book or document certified by or on behalf of the Commissioner is admissible in evidence in court as if it were the original.

16B(4) Inspection by owner The owner of a book or document that is removed under this section is entitled to inspect, and obtain a copy of, the book or document at the premises to which the book or document is removed—

(a) At the time the book or document is removed to the premises:

(b) At reasonable times subsequently.

23. Also relevant are section 20 which relates to legal privilege and sections 20B to 20G which relate to the non-disclosure right for tax advice documents.

Discussion

The Commissioner's powers to obtain information under sections 16 & 16B

24. Section 16 authorises the Commissioner to have full and free access to any place to inspect and copy all books and documents that the Commissioner considers "necessary or relevant".

25. "Necessary or relevant" for the purposes of section 16 means that the book or document is necessary or relevant for any of the following purposes:
    - Collecting any tax or duty under any of the Inland Revenue Acts;
    - Carrying out any other function lawfully conferred on the Commissioner;
    - Likely to provide any information required for the purposes of any of the Inland Revenue Acts or the Commissioner's functions.

26. Occupiers of lands, buildings, or places are required to assist the Commissioner by providing all reasonable facilities and assistance for the effective exercise of section 16 and to answer all proper questions relating to that exercise (section 16(2)).

27. Section 16(3) provides that a private dwelling can only be accessed by obtaining a warrant or with the consent of an occupier.

28. Section 16B was inserted into the TAA in 2003, giving the Commissioner the power to remove books or documents accessed under section 16 in order to make copies. This power was provided to address the risk of books or documents being destroyed, removed, or tampered with in certain cases. The power under section 16B will be exercised in situations where it is necessary to prevent the Commissioner's legitimate investigations being hindered or where copying on the premises is not practicable.

29. As discussed in paragraphs 33 to 36 of this SPS, the removal of books or documents under section 16B includes removing an electronic storage medium for imaging. Consent to remove the book or document for copying is not required by section 16B.

30. If the Commissioner removes a book or document,

the owner is entitled to, at the time of removal or at reasonable times subsequently, inspect and obtain a copy of the book or document that is removed (section 16B(4)). This should assist in minimising any disruption to businesses or other activities that may be caused by the removal of the books or documents. In any case, books and documents that are removed will be copied and returned as soon as practicable.

31. Decisions to access places and to remove books or documents from those places will be made or approved by an Inland Revenue officer delegated to do so on behalf of the Commissioner.

32. Certified copies of books or documents are admissible in evidence in court as if they were the original (section 16B(3)).

Books and documents

33. The definition of "book and document" under section 3 refers to a broad range of items that store or record information, including those that do so electronically.

34. In *Avowal Administration Attorneys Limited & Ors v District Court at North Shore & Anor* [2010] NZCA 183, the Court of Appeal held that a computer hard drive comes within the definition of "book and document". A "record" includes information that is recorded, as well as the medium in which the recording is made. It follows then, that "any other type of record whatever" referred to in the definition should include a computer hard drive.

35. This finding in *Avowal* is also consistent with the observations made in the Court of Appeal in *A Firm of Solicitors v District Court at Auckland* [2006] 1 NZLR 586 where it was observed that a computer hard drive is a "document" that may be [imaged].

36. The courts have confirmed the Commissioner's view that devices that have the ability to store or record information electronically fall within the meaning of "book and document" under section 3 and therefore are subject to removal and imaging under sections 16 and 16B. Also see definition of "electronic storage medium" at paragraph 9.

Relevance search and imaging of the electronic storage medium

37. The Commissioner's powers under sections 16 and 16B are subject to section 21 of the New Zealand Bill of Rights Act 1990, which provides that everyone has the right to be secure against unreasonable search or seizure. Therefore, as a starting point, a relevance search is carried out to enable the Commissioner to be satisfied that the electronic storage medium is necessary or relevant for the purposes of section 16(1) or it is likely to provide information otherwise required for these purposes.

38. In some cases, it may not be practicable for the Commissioner to conduct a relevance search, such as where the data stored on the electronic storage medium is encrypted (making it impossible to carry out a relevance search), or where the information is subject to a claim of legal privilege or non-disclosure right.

39. While the Court of Appeal in *Avowal* noted a preliminary screening of the electronic storage medium to be good practice, it did not see it as necessarily a prerequisite to a reasonable search or access under section 16. The Commissioner may already hold information that provides sufficient ground to be satisfied that the electronic storage medium is "necessary or relevant". The "reasonableness" of a search must be assessed having regard to the circumstances of the case.

40. If the relevance search identifies information of interest, the Commissioner is entitled to image the entire electronic storage medium. The fact that the electronic storage medium also contains irrelevant or privileged information does not mean it cannot be copied or removed. The court in *A Firm of Solicitors* described the removal of a hard drive or the copying of a hard drive as analogous with the removal of a book or a very long document and reasoned that it cannot be contemplated that only pages containing relevant or non-privileged information are torn out and removed from that book or document. Therefore, the Commissioner will image the entire electronic storage medium.

Removal of electronic storage medium

41. *Avowal* also confirmed that where the Commissioner has determined that the information contained in an electronic storage medium is necessary or relevant for a purpose under an Inland Revenue Act or is likely to provide any information otherwise required for these purposes, the Commissioner is entitled to remove that electronic storage medium for copying under section 16B. The reasoning in *A Firm of Solicitors* discussed in paragraph 40 also applies to the removal of the electronic storage medium. The fact that the electronic storage medium contains privileged or irrelevant material should not prevent it from being removed. What is required is a warrant, for the purpose of removal for inspection, with conditions to deal with irrelevant or privileged material appropriately.

42. Section 16B does not require the consent of the occupier before removing the electronic storage medium for imaging.

Non-disclosure right for tax advice documents and legal privilege

43. Confidential communications between legal practitioners and their clients that meet the criteria under section 20 are privileged from disclosure under section 16.
44. Sections 20B to 20G deal with the right of an information holder to not disclose a book or document that is eligible to be a tax advice document. See SPS 05/07: *Non-disclosure right for tax advice documents* (or any subsequent replacements of the SPS) for more information.
45. The Commissioner will adhere to the provisions of sections 20 to 20G regarding legal privilege and the non-disclosure right for tax advice documents when exercising the information-gathering powers, including when imaging electronic storage media.
46. As decided in *A Firm of Solicitors*, the mere removal and imaging of documents that may be legally privileged or subject to non-disclosure right does not breach that right or privilege, as there is no disclosure of those documents. The Commissioner will engage in a process to ensure that these documents are not accessed unless it is necessary to extract those documents to resolve the claim of legal privilege or non-disclosure right.

Standard practice

Accessing the electronic storage medium

47. Section 16 authorises the Commissioner to access all lands, buildings and places to inspect and image electronic storage media if it is considered that the electronic storage media is "necessary or relevant". This includes access using section 16 and obtaining a warrant or with the consent of an occupier to enter a private dwelling.
48. The Inland Revenue officer exercising section 16 may be accompanied by any other person considered necessary for the effective exercise of the power.
49. The Commissioner's entitlement to full and free access to information stored in electronic storage media, together with the requirement in section 16(2) that the occupier of the premises must provide the Commissioner with all reasonable facilities and assistance for the effective exercise of the Commissioner's powers under section 16, means that the occupier must provide, for example, decryption codes and passwords in order to access the data stored in the electronic storage media.
50. It is the Commissioner's view that reasonable force can be used to obtain full and free access to an electronic storage medium. Reasonable force would be, for example, removing the need to use a password on a computer or disassembling a computer in order to access the computer hard drive.

Carry out a relevance search

51. A relevance search is carried out to determine whether the electronic storage medium contains information that is necessary or relevant or is likely to provide any information otherwise required.
52. If the relevance search reveals that the electronic storage medium contains information of interest, that entire electronic storage medium will be imaged. Generally, the imaging is performed on-site where the electronic storage medium is located.
53. The occupier will be given information about the right to claim legal privilege and non-disclosure right for tax advice documents. If a claim to legal privilege or the non-disclosure right for tax advice documents is made over the contents of an electronic storage medium, a relevance search will not be carried out and the electronic storage medium will be sealed or imaged then sealed. (See paragraphs 64 to 70 on the process for dealing with legal privilege and non-disclosure right.)
54. Further, a relevance search will not be carried out where it is not practicable for the Commissioner to do so, such as where the data is encrypted. In these cases, the encrypted electronic storage medium will be imaged without carrying out a relevance search.
55. As mentioned in paragraph 39, the Commissioner may already hold information that provides sufficient ground to be satisfied that the electronic storage medium is "necessary or relevant" without carrying out a relevance search. Not carrying out a relevance search in some cases does not necessarily lead to an unreasonable search and seizure of the electronic storage medium.

Removal of electronic storage media

56. The Commissioner's preference is to image electronic storage media on the premises accessed under section 16. However the removal of electronic storage media for the purposes of imaging is provided for in section 16B. The decision to remove the electronic storage media will be made by an appropriately delegated Inland Revenue officer.
57. Section 16B provides for the removal of electronic storage media for the purpose of imaging. The Commissioner may take into consideration any relevant factors when deciding to remove an electronic storage

medium for imaging, including but not limited to the following:

- Volume of data stored on the electronic storage medium;
- Whether it is appropriate or practicable for the electronic storage medium to be removed;
- The time it may take to image the electronic storage medium on-site (to avoid prolonged occupation at the premises or disruption to business);
- The occupier's preference for the removal of the electronic storage medium or any reasonable alternatives as suggested by the occupier; and
- Whether it is appropriate for the Inland Revenue officers to remain at the premises. For example, access to a private dwelling where children are present or may be expected.

In any case, if the Commissioner has reasonable grounds to believe that there is a risk to the information stored on the electronic storage medium, the electronic storage medium will be removed.

58. While the information stored on a computer hard drive can be regarded as falling within the meaning of "book and document" and is removable under section 16B, the computer itself does not. However, if the hard drive of a computer is not readily removable, the entire computer may need to be removed in order to image the hard drive. Consent is not necessary but the criteria for removal in paragraph 57 will be applied.

59. Where it is not appropriate for Inland Revenue officers to remain at the premises, or where the occupier has expressed their preference for removal, the electronic storage medium will be removed. The Commissioner will follow the same process of carrying out a relevance search on the electronic storage medium off-site, and the device will be imaged if the relevance search identifies information that is necessary or relevant or is likely to provide any information otherwise required.

60. A receipt detailing the items removed and the date of removal will be provided to the occupier at the time of removal.

61. If legal privilege or the non-disclosure right is claimed, an undertaking will be provided that the contents of the electronic storage medium will not be viewed until such claims have been dealt with, unless it is necessary to view the contents to resolve the claim of legal privilege or non-disclosure right.

62. The electronic storage media that are removed will be taken to a site where they will be imaged by a qualified technician and returned to the occupier as soon as practicable. An indication will be given to the occupier at the time of removal as to when the electronic storage media will be returned, having regard to the amount of data to be imaged.

63. To minimise any disruption to business or other activities, the owner of the electronic storage medium is entitled to inspect and obtain a copy of the electronic storage medium that is removed, at the time of removal or at reasonable times subsequently.

Protection of non-disclosure right for tax advice documents and legal privilege

64. An electronic storage medium may contain information that may be subject to legal privilege or tax advice documents that are protected by the non-disclosure right under the TAA.

65. The occupier will be given an opportunity to claim legal privilege or non-disclosure right for tax advice documents before a relevance search is carried out. Alternatively, a claim of non-disclosure right may be made by a later date as agreed by the Commissioner. Legal privilege and non-disclosure right may be claimed by providing the name of the legal practitioner or the tax advisor to the Inland Revenue officers. (Note that this differs from the process for claiming the right of non-disclosure as set out in SPS 05/07.)

66. If a claim to legal privilege or the non-disclosure right for tax advice documents is made over the contents of an electronic storage medium, it is the Commissioner's view that the information in the electronic storage medium should be preserved in order to deal with the claim at a later stage (see paragraph 68). In these circumstances, a relevance search will not be carried out. However, to protect the claim, the Commissioner will either:

- Seal the original electronic storage medium; or
- Image the electronic storage medium then seal the imaged copy and return the original. This would allow a business to continue to operate.

67. The sealed item will be held in a secure place that has restricted access and is independent from the investigation. The Inland Revenue officers will provide an undertaking that the sealed item would not be viewed, unless viewing it is unavoidable while carrying out the step in paragraph 68.

68. The Commissioner will attempt to deal with the claim of legal privilege or the tax advice status of information by negotiation with the person making the claim. To identify documents that may be legally privileged or that may be tax advice documents, the Commissioner will request names and keywords that may identify

these documents. These documents will then be filtered and provided to the person to decide which documents they want to claim legal privilege or tax advice status on. The person will be given sufficient time in order to make the claim. The filtering of the documents will be carried out by a trained technician who is independent from the investigation.

69. If the claim of legal privilege or the non-disclosure of tax advice documents cannot be resolved between the Commissioner and the person making the claim, the Commissioner may apply to a District Court Judge for orders under section 20(5) as to whether the claim for legal privilege is valid, or under section 20G as to whether the document is a tax advice document (or for related orders regarding tax contextual information).

70. Only documents that are relevant and not treated as legally privileged or tax advice documents will be relied on by the Commissioner.

Protection of secrecy

71. Section 81 requires Inland Revenue officers to maintain the secrecy of all matters relating to the Inland Revenue Acts that come to the officer's knowledge, including all information stored on electronic storage media. The prohibition on disclosure also applies to information on the electronic storage media that is not relevant to an Inland Revenue Act, for example marketing information on a company's new product.

72. Accordingly, Inland Revenue will not disclose any information obtained except where it is in the course of carrying into effect an Inland Revenue Act.

73. The maintenance of secrecy provisions in the TAA extend to any third parties that may accompany the Commissioner in the exercise of the section 16 power.

This Standard Practice Statement is signed on the 14th day of July 2010.

Rob Wells

LTS Manager, LTS Technical Standards

SPS 10/03: ACCEPTANCE OF LATE OBJECTIONS UNDER SECTION 92(2) OF THE CHILD SUPPORT ACT 1991

Introduction

1. This Standard Practice Statement 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 ("the CSA").
2. This matter was previously included in SPS INV-300: *Acceptance of late objections under section 126 of the Tax Administration Act 1994*, published in March 1997. SPS INV-300 has been withdrawn (refer to notice of withdrawal in *Tax Information Bulletin* Vol 21, No 3 (May 2009)).
3. For the purposes of this statement "objector" means "liable person" and or "custodian" under the CSA.

Background

4. Section 92(1) of the CSA provides that objections are to be delivered or posted to the Commissioner within 28 days after the date on which notice of the decision or assessment objected to was given by the Commissioner. However, section 92(2) of the CSA provides a discretion to allow the Commissioner to accept a late objection.
5. The Court of Appeal in *CIR v Wilson* (1996) 17 NZTC 12,512 considered it impossible to lay down absolute rules as to what factors will always be relevant to the determination of a late objection request. The Court however in effect, did suggest a two step approach in considering requests. In summary, the first step is to consider the objector's explanation for the lateness of the objection. A reasonable explanation is all that is required at this stage. The second step is to consider all the surrounding circumstances and decide whether, as a matter of fairness, the application should be allowed.
6. The steps are:

   Step 1

   Consider the explanation given by the objector for their failure to make a timely objection. Where there has been a delay, the reasons for the failure to make the objection within the required time will be considered.

   Depending on the circumstances, it may be relevant to consider whether the failure to object in time was due to inadvertence, negligence, an agent's action or a deliberate decision of the objector. These factors may weigh against the objector.

   A reasonable explanation to explain the delay is all that is required at this point. For example, where the delay was caused by:

   - the ill health of the objector, or
   - other circumstances beyond their control, such as the objector being overseas during the whole of the 28 day objection period and there were no arrangements in place to receive and deal with notices.

   This will generally be sufficient to satisfy step 1.

   If there is some merit in the explanation given (that is, it provides reasonable justification for the failure to object in time), the objection will be considered further in accordance with step 2.

   If, however, the explanation is inadequate, the objection can be rejected making it unnecessary to proceed to step 2.

   Under section 92(3) of the CSA, the details and grounds of the late objection must be given at the same time as the explanation for the delay.

   Step 2

   The Commissioner will consider all the circumstances surrounding the objection to decide whether, as a matter of fairness, the objection should be allowed.

   This may mean some duplication of those matters considered in step 1 (reasons for the delay in making the late objection). However, the purpose at step 2 is to determine whether in the light of all the circumstances, and as a matter of fairness the objection should be allowed.

   The Court of Appeal in *Wilson* noted that although obtaining a correct assessment may be an important factor, it would be going too far to say it is the paramount consideration in deciding whether to accept a late objection. A number of factors have been identified as potentially relevant in this regard. These are set out in Appendix A.

Claims where there has been a clear error

Where there is a clear error in the assessment or decision, an amendment may be made under section 87 of the CSA.

Other claims

If the error can be established only after further investigation or consideration, (and the error does not arise from a subsequent change in interpretation of the law), the procedures set out in steps 1 and 2 will need to be followed. A liberal approach should be taken when considering such claims.

Weighting of factors

7. The weighting to be given to the factors which are taken into account in deciding whether or not to accept a late objection, is to be decided by the Commissioner on the circumstances of each case.

Recording the decision

8. It is important that the factors taken into account in deciding whether or not to accept a late objection be adequately documented.
9. A detailed report will be prepared, addressed to the person who will be making the decision whether to accept the late objection, or not. This report will set out the factors which have been taken into account, the weight that has been applied to each factor and the reasons for the recommendation.
10. The person making the decision is to include their comments including their reasoning and the resulting decision.

No appeal or objection rights

11. There are no appeal or objection rights under the CSA where the Commissioner does not exercise his discretion to accept a late objection. However, the decision can be challenged by way of judicial review to the High Court.
12. Should judicial review proceedings arise, evidence of the decision making process will need to be produced to the Court. It will enhance the evidence which can be produced to the Court, if the factors taken into account and the reasons for making the decision are recorded at the time. This evidence may include an affidavit from the officer who made the decision to decline the late objection, all relevant correspondence, file notes, phone call notes, signed reports and system notes.

This Standard Practice Statement is signed on the 15th day of July 2010.

Rob Wells

LTS Manager, LTS Technical Standards

APPENDIX A

Factors which may be relevant in considering a late objection request (to be considered under "step 2" of the process)

Some factors which support the acceptance of a late objection are:

- If the proposed objection has apparent merit. This may and often will be a relevant factor. This can only be assessed on the material before the Commissioner when asked to accept a late objection and need not be investigated to the point of allowance or disallowance. It will not usually be necessary for Inland Revenue to make further enquiry to determine the merits in order to make a decision. In some cases however, a moment's check may show that the quantification of liability in the assessment was erroneous.
- If the objector had consistently asserted their entitlement and only failed to lodge an objection due to the Commissioner's insistence that the entitlement was not available to them.
- If there are no practical or administrative difficulties in considering the situation at that time (e.g. they are part of a readily identifiable group, the evidence is immediately available and no practical obstacles exist to its application).
- The objectors have been told that a "test case" would apply to them.
- When an assessment notice or decision has been sent to the objector's home and the objector is temporarily away during the 28 day objection period.
- The serious ill health or death of an agent, or the agent's office is shut for annual holidays.
- When granting the relief requested would not violate the Commissioner's responsibility to be even handed.
- When the objector is seeking legal or other professional advice.
- When the objector is ignorant of procedures to follow.
- When the objector has fallen ill.

Some factors which support declining a late objection are:

- If an objector has a professional adviser, Inland Revenue may be reluctant to accept a late objection as a professional advisor should generally be aware of the legislative requirements of the CSA. Omitting to lodge an objection because of an oversight by the objector or their advisor will usually not on its own constitute satisfactory grounds for accepting a late objection.
- The extent to which an objection is late and any history of making late objections by either the objector or the agent.
- The Commissioner would not be required to exercise discretion where the objector had never contemplated seeking a benefit but had endeavoured to take advantage of a subsequent change in the interpretation of the law, such as by way of a subsequent court decision or issue of a Standard Practice Statement.

All circumstances are to be considered. The above factors are guidelines only and are not exhaustive. They are not intended to restrict the discretion given to the Commissioner. Decision makers should always remain open to the possibility of new factors arising in any case that may make it unfair not to accept the objection.

QUESTIONS WE'VE BEEN ASKED

QB 10/05: SECTION 78(3) OF THE GOODS AND SERVICES TAX ACT 1985

Section 78(3) of the Goods and Services Tax Act 1985 relevantly provides that, where an alteration in the law is made (such as an increase in the rate of GST), any fee, charge or other amount prescribed by or determined pursuant to any Act or regulation in respect of any supply of goods or services shall, *unless provision to the contrary is contained in that Act or regulation*, be deemed to be modified so as to increase the amount of fee or charge by the amount of tax chargeable.

We have been asked whether the phrase "unless provision to the contrary is contained in that Act or regulation" in section 78(3) is triggered merely by a reference to an amount being "GST inclusive".

An item in *Public Information Bulletin* No. 181 (June 1989), stated that where an Act or regulation provides that a fee or charge is inclusive of GST, section 78(3) will not apply to allow the relevant Department to increase that amount to take into account the increase in the rate of GST. Such a provision was considered to be a contrary provision for the purposes of section 78(3).

The Commissioner now considers that the above statement is incorrect. For section 78(3) to not apply when the GST rate increases from 1 October 2010, there must be an explicit statement in the Act or regulation that the amount charged must not be increased by the change in the GST rate. It is not sufficient that the amount is stated to be "GST inclusive". If there is no contrary provision in the Act or regulation, the relevant Department will be able to increase the amount to take into account the change in the GST rate effective from 1 October 2010.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

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Policy Advice Division

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