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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

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

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

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED0134	Draft general depreciation determination: Plumbing display products & stands	This draft general depreciation determination proposes to add a new asset class to the "Shops" industry category for plumbing display products and stands.	11 August 2011

Correction – to TIB Vol 23, No 3 (April 2011)

The 2011 International tax disclosure exemption was incorrectly cited as ITR21 in this issue of the TIB.
This exemption should be cited as "International Tax Disclosure Exemption ITR22".

IN SUMMARY

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This determination declares the Canterbury earthquake of 4 September 2010 as an emergency event for the purposes of section MB 13(2)(r)(i) of the Income Tax Act 2007. This means a payment made in the stated time period to relieve the adverse effects of the Canterbury earthquake of 4 September 2010 is excluded from being family scheme income under section MB 13(1).

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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 DET EE-11/01: DECLARATION OF THE CANTERBURY EARTHQUAKE OF 4 SEPTEMBER 2010 AS AN EMERGENCY EVENT FOR THE PURPOSES OF FAMILY SCHEME INCOME

This determination may be cited as "Determination DET EE-11/01: *Declaration of the Canterbury Earthquake of 4 September 2010 as an emergency event for the purposes of family scheme income*".

1. Application

This determination applies to the Canterbury earthquake of 4 September 2010.

2. Determination

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

Emergency Event

Canterbury earthquake of 4 September 2010 is declared to be an emergency event for the purposes of section MB 13(2)(r)(i) of the Income Tax Act 2007.

Time Period

For the purposes of section MB 13(2)(r)(ii) of the Income Tax Act 2007, the period relating to the event is set at 12 months from 4 September 2010 to 3 September 2011.

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 26th day of May 2011.

Rob Wells
LTS Manager, Technical Standards

COMMENTARY ON DETERMINATION

This commentary does not form part of the determination. It is intended to provide assistance in the understanding and application of the determination.

Section 91AAS of the Tax Administration Act 1994 provides the Commissioner the power to issue a determination declaring an event as an emergency event for the purposes of section MB 13(2)(r)(i) of the Income Tax Act 2007.

In setting this determination, the Commissioner must set a period relating to the event for the purposes of section MB 13(2)(r)(ii) of the Income Tax Act 2007 up to a maximum period of 12 months from the date of the event.

Section MB 13(1) of the Income Tax Act 2007 took effect from 1 April 2011 and includes in the family scheme income (which is used in the calculation of a person's Working for Families Tax Credit entitlement) of a person the value of payments paid to the person used to replace lost or diminished income or used to meet usual living expenses.

Section MB 13(2) of the Income Tax Act 2007 excludes certain payments from being included in family scheme income under section MB 13(1). Section MB 13(2)(r) excludes from family scheme income a payment made to relieve the adverse effects of an event declared an emergency event by the Commissioner by way of determination under section 91AAS of the Tax Administration Act 1994 where the payment is made in the time period set by the Commissioner in the determination.

This determination declares the earthquake that occurred in Canterbury on 4 September 2010 as an emergency event and sets a 12-month time period for the purposes of section MB 13(2)(r) from 4 September 2010 to 3 September 2011.

Section MB 13(2)(r) came into force 1 April 2011 which is the day section MB 13(1) came into force. Therefore a payment made between 1 April 2011 and 3 September 2011 (inclusive of both dates) to relieve the adverse effects of the Canterbury earthquake of 4 September 2010 will not be included in a person's family scheme income under section MB 13(1).

DETERMINATION DET EE-11/02: DECLARATION OF THE CANTERBURY EARTHQUAKE OF 22 FEBRUARY 2011 AS AN EMERGENCY EVENT FOR THE PURPOSES OF FAMILY SCHEME INCOME

This determination may be cited as "Determination DET EE-11/02: *Declaration of the Canterbury Earthquake of 22 February 2011 as an emergency event for the purposes of family scheme income*".

1. Application

This determination applies to the Canterbury earthquake of 22 February 2011.

2. Determination

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

Emergency Event

The Canterbury earthquake of 22 February 2011 is declared to be an emergency event for the purposes of section MB 13(2)(r)(i) of the Income Tax Act 2007.

Time Period

For the purposes of section MB 13(2)(r)(ii) of the Income Tax Act 2007, the period relating to the event is set at 12 months from 22 February 2011 to 21 February 2012.

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 26th day of May 2011.

Rob Wells
LTS Manager, Technical Standards

COMMENTARY ON DETERMINATION

This commentary does not form part of the Determination. It is intended to provide assistance in the understanding and application of the Determination.

Section 91AAS of the Tax Administration Act 1994 provides the Commissioner the power to issue a determination declaring an event as an emergency event for the purposes of section MB 13(2)(r)(i) of the Income Tax Act 2007.

In setting this determination, the Commissioner must set a period relating to the event for the purposes of section MB 13(2)(r)(ii) of the Income Tax Act 2007 up to a maximum period of 12 months from the date of the event.

Section MB 13(1) of the Income Tax Act 2007 includes in the family scheme income (which is used in the calculation of a person's Working for Families Tax Credit entitlement) of a person the value of payments paid to the person used to replace lost or diminished income or used to meet usual living expenses.

Section MB 13(2) of the Income Tax Act 2007 excludes certain payments from being included in family scheme income under section MB 13(1). Section MB 13(2)(r) excludes from family scheme income a payment made to relieve the adverse effects of an event declared an emergency event by the Commissioner by way of determination under section 91AAS of the Tax Administration Act 1994 where the payment is made in the time period set by the Commissioner in the determination.

This determination declares the earthquake that occurred in Canterbury on 22 February 2011 as an emergency event and sets a 12-month time period for the purposes of section MB 13(2)(r) from 22 February 2011 to 21 February 2012.

Section MB 13(2)(r) came into force 1 April 2011 which is the day section MB 13(1) came into force. Therefore a payment made between 1 April 2011 and 21 February 2012 (inclusive of both dates) to relieve the adverse effects of the Canterbury earthquake of 22 February 2011 will not be included in a person's family scheme income under section MB 13(1).

FLEET TRACKING UNIT – DEPRECIATION

The Commissioner has set a provisional depreciation rate for a fleet tracking unit.

Fleet tracking units are hardwired into a vehicle and enable the vehicle's home base to monitor the vehicle's position via a mobile phone network, or an internet server. The sophistication of a fleet tracking unit can range from a simple tracking unit that shows the location of a fleet vehicle on a map, to more elaborate custom applications that can provide a dashboard-style view of all fleet vehicles on a map plus information about the condition and use of each vehicle, for example, when the vehicle exceeds the speed limit, when a fault occurs in the vehicle, or when scheduled maintenance is due. Fleet tracking units can also include the ability for fleet managers to send and receive text messages to and from the vehicle.

This provisional depreciation rate determination does not apply to plug-n-play GPS map display units used by drivers for navigation purposes.

DETERMINATION PROV21: TAX DEPRECIATION RATES PROVISIONAL DETERMINATION NUMBER PROV21

This determination may be cited as "Determination PROV21: *Tax depreciation rates provisional determination number PROV21*".

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 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 "Transportation" 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 (%)
Fleet tracking unit	6	30	21

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 June 2011.

Rob Wells
LTS Manager, Technical Standards

INTERPRETATION STATEMENTS

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

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

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

IS 11/01: INCOME TAX – DEPRECIATION: MEANING OF "OBSOLESCENCE" IN THE DEFINITION OF "ESTIMATED USEFUL LIFE"

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

Summary

1. This Interpretation Statement sets out the Commissioner's view on the meaning of the term "obsolescence" in s EE 63. This statement also sets out practical examples of the kinds of considerations that the Commissioner will take into account when setting the estimated useful life of an item of depreciable property based on obsolescence.
2. Section EE 63 defines the term "estimated useful life". The estimated useful life of an item of depreciable property ("an item") is used to set the depreciation rate for that item. The longer the estimated useful life of an item, the lower the depreciation rate for that item will be. The shorter the estimated useful life of an item, the higher the depreciation rate will be. There is, therefore, a timing advantage in having a shorter, rather than longer, estimated useful life. A person is allowed a deduction for an amount of depreciation loss for items of depreciable property that they own using an appropriate depreciation rate. Section EE 63 provides that certain factors must be taken into account when determining the estimated useful life of an item. One of the factors in s EE 63, which is relevant to setting general, special and provisional depreciation rates, is "obsolescence".
3. The word "obsolescence" may have different meanings in different contexts. In the context of s EE 63, obsolescence involves a reduction in the period for which an asset might be expected to be useful in deriving assessable income for reasons (other than physical deterioration or wear and tear) such as economic, technological or other external causes that affect the estimated useful life of the item. The estimated useful life of an item is relevant when the Commissioner sets a general depreciation rate, or considers applications for special or provisional depreciation rates. Obsolescence will cause an item to no longer be useful in deriving assessable income before the end of its physical life. However, an obsolete item will not necessarily be completely useless.
4. Whether an item is affected by obsolescence is a question of fact to be judged objectively. An item will be obsolete if causes external to that item, and outside the control of the taxpayer, will result in it being no longer useful in deriving assessable income before the end of its physical life. For obsolescence to affect the estimated useful life of an item, there must be a reasonable certainty that it will become obsolete and a sufficiently clear indication of when this would be likely to occur. The nature of obsolescence can be described in the following terms:
   - Obsolescence is the process whereby an asset loses its economic usefulness or ability to function in a business through causes other than physical deterioration or wear and tear.
   - Obsolescence may arise from factors that are inherent to the item (functional obsolescence) or that constitute a change to the environment or conditions surrounding an item (economic obsolescence).
   - Obsolescence may arise from such circumstances as changes in the way in which the business is undertaken, shifting of business centres, loss of trade, technological changes, new inventions, inadequacy, and prohibitory laws where those factors result in a decrease in the estimated useful life of the item by making that item become obsolete.
   - Obsolescence may arise from technological changes or the development of more modern improved alternatives that are significant enough to affect the useful life of an item and mean that the item

has been superseded by improvements. However, obsolescence does not equate to an item simply being suboptimal or there being "better" or more modern alternatives. The difference is that the more modern improved alternatives must be significant enough to affect the estimated useful life of the item.

5. Obsolescence is not contributed to by the following:
   - The mere presence of a business failure or market forces of supply and demand that do not impact on the item. For instance, a desire to cease, enhance, or expand business operations will not contribute to obsolescence.
   - The mere fact that an item is abandoned, demolished or scrapped or that there is a decision to do so. The presence and impact of obsolescence must be determined having regard to the status of the item before its abandonment, demolition or scrapping.
   - The availability of newer or better alternatives, which do not affect the estimated useful life of the item.
6. An item can become obsolete in many different ways. Therefore, this statement does not provide an exhaustive list. As stated above, whether an asset is becoming obsolete is a question of fact to be determined objectively. In considering whether an item is affected by obsolescence, in each particular case, the focus is on establishing whether there is a set of considerations that will affect the usefulness of an item or, in other words, the item's estimated useful life.
7. Where obsolescence is present, the item will eventually become unsuitable for the purposes of the business, such that the item will no longer contribute to the income-earning process. This requires a reasonable certainty that an item will become obsolete, and a sufficiently clear indication of when this would be likely to occur, for obsolescence to affect the estimated useful life of the item.

Analysis

8. This analysis explains the meaning of the word "obsolescence" in s EE 63. The Commissioner must take any obsolescence into account when setting the estimated useful life of an item. This Interpretation Statement analyses the wording and statutory context of s EE 63 and relevant case law.
9. The following analysis considers the statutory context of s EE 63 together with the ordinary and commercial meaning of the word "obsolescence" and analyses the case law on the term "obsolescence". This statement then explains what the Commissioner will take into account when determining whether obsolescence is affecting an item's estimated useful life.

Statutory context for the term "obsolescence" in s EE 63

10. Section DA 1(1) provides that a person is allowed a deduction for an amount of expenditure or loss. However this is only to the extent to which the expenditure or loss is incurred by the person in deriving their assessable or excluded income or both, or in the course of carrying on a business for the purpose of deriving assessable or excluded income or both.
11. Generally, a person is not allowed a deduction for a capital item: s DA 2(1). However, s DA 4 overrides s DA 2(1) by expressly providing that a person is allowed a deduction for an amount of depreciation loss.
12. Section EE 1 provides that subpart EE quantifies the amount of depreciation loss a person is allowed as a deduction under Part D of the Act. Depreciation loss refers to the amount of depreciation allowable in an income year under s EE 1(2). Section EE 1 also quantifies the amount of depreciation recovery income that is income under Part C. Depreciation recovery income arises when a person disposes of an item of depreciable property.
13. In setting a depreciation rate for an item the Commissioner must determine the "estimated useful life" of an item based on the definition of that term in s EE 63. Section EE 63(1) provides the following definition of the term "estimated useful life":

> **EE 63 Meaning of estimated useful life**
>
> *Meaning for item of depreciable property, except for copyright in sound recording*
>
> (1) Estimated useful life, for an item of depreciable property, other than a copyright in a sound recording, means the period over which the item might reasonably be expected to be useful in deriving assessable income or carrying on a business for the purpose of deriving assessable income, taking into account—
>
> (a) the passage of time, likely wear and tear, exhaustion, and obsolescence; and
>
> (b) an assumption of normal and reasonable maintenance.

14. The purpose of s EE 63 is to determine the estimated useful life of an item, taking into account the passage of time, likely wear and tear, exhaustion, and obsolescence. The estimated useful life of an item is relevant when the Commissioner sets a general depreciation rate, or considers applications for

special or provisional depreciation rates. A person may apply for a special depreciation rate when the general economic rate for that item is not appropriate. Depending on a taxpayer's particular circumstances, alternatives to applying for a special rate include writing off the item (s EE 39) or disposing of the item and claiming a depreciation loss for the amount by which the consideration is less than the item's adjusted tax value (s EE 48(2)).

15. In setting the estimated useful life of an item, the Commissioner must make a reasonable estimate of the period for which an item might be expected to be useful in deriving assessable income. This estimate is based on information available to the Commissioner at the time the rate is set. The longer the estimated useful life of an item, the lower the depreciation rate for that item will be. The shorter the estimated useful life of an item, the higher the depreciation rate will be. There is, therefore, a timing advantage in having a shorter, rather than longer, estimated useful life.

16. "Obsolescence" is not defined in the Act. Therefore, it is necessary to interpret the meaning of the term "obsolescence" as it is used in s EE 63. The following analysis considers the ordinary and commercial meaning of the term "obsolescence" and relevant case law.

Ordinary meaning of the term "obsolescence"

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

> **1** The process or state of becoming obsolete or falling into disuse … ▸ **b** A diminution in the value or usefulness of consumer goods, machinery, etc., owing to technological advances, changes in demand, etc.

18. In addition, "obsolete" is defined as:

> **A** *adjective*. **1** No longer practised or used; going out of use, out of production, or out of date.
>
> **B** *noun*. A thing which is out of date or has fallen into disuse;

19. *Black's Law Dictionary* (8th ed, Thomson West, St Paul, Minnesota, 2004) defines "obsolescence" as:

> **Obsolescence, 1.** The process or state of falling into disuse or becoming obsolete. **2.** A diminution in the value or usefulness of property, esp. as a result of technological advances. For tax purposes, obsolescence is usu. distinguished from physical deterioration. Cl. DEPRECIATION. [Cases: Taxation 348(4).]
>
> **economic obsolescence.** Obsolescence that results from external economic factors, such as decreased demand or changed government regulations. – Also termed external obsolescence. Cf. functional obsolescence.
>
> **external obsolescence.** See economic obsolescence
>
> **functional obsolescence.** Obsolescence that results either from inherent deficiencies in the property, such as inadequate equipment or design, or from improvements in the property since its use began. Cf. economic obsolescence.
>
> **planned obsolescence.** A system or policy of deliberately producing consumer goods that will wear out or become outdated after limited use, thus inducing consumers to buy new items more frequently. – Also termed built-in obsolescence.

20. The dictionary meaning of these words indicates that obsolescence involves a reduction in the usefulness (and so the value) of an item for reasons other than physical deterioration or wear and tear. Examples of obsolescence are losses of value or usefulness of an item as a result of inherent deficiencies in that item, rapid technological advances, changes in the demand for products, or changes in government regulation. Obsolescence is also described as a process that suggests items affected by obsolescence will continue to have some utility until they become obsolete. The result is that the item will become obsolete, or fall into disuse, before the end of its physical life.

Commercial meaning of the term "obsolescence"

21. The notion of obsolescence is also frequently referred to in commercial contexts. Again, obsolescence is distinguished from physical deterioration or wear and tear. Often, although not always, the cause of the item becoming obsolete will be external to that item of property, such as economic changes, technological advances and changes in demand that affect the estimated useful life of an item.

22. The *Penguin Dictionary of Economics* (7th ed, Penguin Books, London, 2003) defines obsolescence as (at p 281):

> A reduction in the useful life of a capital good or consumer durable through economic or technological change or any other external (durable goods) changes, as distinct from physical deterioration in use (depreciation). For example, a new process or machine may be developed that renders existing equipment uneconomic because a firm could significantly reduce its costs by scrapping its existing machinery even though it might still have many years of physical life. Then the old equipment has become obsolescent.

23. The *CCH Macquarie Dictionary of Accounting* (Business ed, CCH Australia, Sydney, 1991) defines obsolescence as:

> Obsolescence – the state of having gone out of use, become out of date, especially as caused by new alternatives being available. An asset (e.g. machinery) may become obsolete when a more cost-effective alternative

> appears on the market. Obsolescence is one of the factors which determines the useful life of a non-current asset. It can be hard to predict, as it is closely related to the technological advances and changes in demand.

24. The *Dictionary of Accounting and Finance Terms* (4th ed, Addison Wesley Longman, Auckland, 1996) defines obsolescence as:

> The outdating of a product or process caused by improved alternatives becoming available that will be more cost-effective resulting in a decline in the market value of an asset. The decline in market value is unrelated to physical changes in the asset itself. Obsolescence is one of the factors which determines the economic life of a fixed asset, which in turn is one of the elements determining the basis of depreciation charged against the fixed asset.

25. These definitions show that obsolescence is a reduction in usefulness due to causes other than physical deterioration or wear and tear, such as economic, technological, or other external causes that affect the estimated useful life of the item.

26. The commercial commentaries appear to have extended the meaning of "obsolescence" to situations where an item may lessen in usefulness simply because more efficient alternatives are developed. The Commissioner considers that this expanded commercial definition of obsolescence is not directly applicable to the meaning of "obsolescence" in s EE 63. This is because, in the context of s EE 63, in order for obsolescence to be taken into account, the availability of newer and better alternatives must be significant enough to reduce the estimated useful life of the item. The relevant case law shows that the availability of newer or better alternatives will cause an item to become obsolete only if the item has been "superseded by improvements". In the situation described by the *Penguin Dictionary of Economics* (where an item is scrapped because it is uneconomic) to establish obsolescence for income tax purposes it would be necessary to show that the scrapping of the item is or will be necessary because, for example, new parts are no longer available.

Case law

New Zealand case law on obsolescence

27. The term "obsolescence" in s EE 63 has not been judicially discussed in any New Zealand cases. However, in *Para Handkerchief & Textiles (1964) Ltd v CIR* (1992) 14 NZTC 9,125, the High Court considered the meaning of the phrase "by the fact of the asset becoming obsolete or useless" as it appeared in s 108(1)(b) of the Income Tax Act 1976. Section 108 of the Income Tax Act 1976 was the predecessor to the current depreciation rules and where applicable, gave the Commissioner the power to allow such deduction as the Commissioner thought just. The High Court determined that the assets owned by the company suffered a reduction in value, not because they had become "obsolete or useless" but because the company could not operate profitably and the assets had to be sold for the best price that could be achieved. The decreased price received was caused, not by the state of the assets, but because of supply and demand.

28. The High Court judgment in *Para Handkerchief* is relevant to determining the meaning of the term "obsolescence" as this case considered the process of an item becoming obsolete. Jaine J stated (at p 9,128):

> The wording of sec 108 is not such that it is necessary to establish that depreciation caused the asset to become "useless" but rather the converse, namely, that an asset has depreciated "by the fact of the asset becoming … useless".

29. Obsolescence can contribute to a reduction in the economic usefulness of property through causes other than physical deterioration. Unlike depreciation as a result of "fair wear and tear", the High Court in *Para Handkerchief* stated that obsolescence is not always as a result of a gradual process (at p 9,128):

> This Court could readily accept that depreciation caused by "fair wear and tear" denotes a gradual process. Similarly depreciation could occur "by the fact of the asset becoming obsolete or useless" where that state has been reached gradually - but that is not necessarily so in relation to obsolescence or uselessness. It is possible to conceive of situations where that state has been caused by rapid technological changes or a particular event or series of events which may occur in a short space of time.

30. In *Para Handkerchief* the relevant items had been disposed of before the taxpayer's claim for obsolescence. Disposal or termination of use is not a requirement in the New Zealand statutory context for the Commissioner to determine whether obsolescence is relevant. Where an item is disposed of or its use is terminated, however, the Commissioner considers that the presence or absence of obsolescence is to be determined before the item is disposed of or its use terminated.

Objective test for obsolescence

31. In *Para Handkerchief* the taxpayer pointed to the United Kingdom High Court of Justice (King's Bench Division) decision in *South Metropolitan Gas Company v Dadd* (1927) 13 TC 205 and submitted that the test for obsolescence should be a subjective test. Jaine J rejected a subjective test for determining if obsolescence was relevant, stating (at p 9,130):

But it does not follow from the dictum of Rowlatt J that he was saying that "obsolete" means "obsolete in the hands of or in the opinion of the taxpayer" ie the subjective test urged on this Court by the objector – otherwise *South Metropolitan Gas Company v Dadd* would have been decided differently.

Indeed that was recognised by Rowlatt J when he concluded his judgment in this way:

> "It is impossible for me to say on the facts here that this ship was, as a matter of fact, obsolete, because, unless I were to say that whenever a man says a thing is obsolete, it is obsolete, I could not decide that, and it is impossible to say that. There is always the possibility ... that the Company here merely wanted something rather better, not because the old thing had been superseded by improvements, but they wanted rather a better ship, because it would suit their purposes better ... and I think under those circumstances, it is open to the Commissioners to say the plant has not become obsolete ..."

Whether an asset has become "obsolete" or "useless" is a question of fact but it cannot be said that if a taxpayer claims an asset is "obsolete" or "useless" because it either chooses not to use it or cannot use it by reason of business failure then the Commissioner is bound to accept that it is "obsolete" or "useless" within sec 108(1)(b).

32. The objective test for obsolescence means that items a taxpayer considers to be obsolete or less useful to them may not necessarily be affected by obsolescence.

Presence of obsolescence is a question of fact

33. In *Para Handkerchief* Jaine J considered *South Metropolitan Gas Company* and the Supreme Court of South Australia decision in *Robertson v Commissioner of Taxes* [1928] SASR 313. Jaine J noted that the statutory regimes considered by those cases were different to that contained in s 108 of the Income Tax Act 1976. This was because the sections considered by those cases related to a situation in which a taxpayer had replaced the item said to have become obsolete and the deduction was allowed only to the extent of the cost of the replaced item after deduction of earlier allowances for fair wear and tear and any sum realised from the sale of that item. This was intended to encourage the purchase of new items. Further, the Australian provision considered in *Robertson* also required the useless state to have resulted from wear and tear, which is not a requirement for obsolescence because wear and tear is provided for separately in s EE 63(1)(a). As stated by Jaine J in *Para Handkerchief,* obsolescence does not require the obsolete state to be reached gradually (like wear and tear). Therefore, the United Kingdom and Australian case law on obsolescence or uselessness must be interpreted with these comments in mind.

34. The decision in *South Metropolitan Gas Company* concerned a taxpayer who owned and operated steamships carrying coal. The taxpayer replaced an old steamship with a superior vessel. Rowlatt J upheld the Special Commissioner's decision that obsolescence was not relevant.

35. Rowlatt J refused to interfere with the decision of the Special Commissioners that obsolescence was not relevant in this case because obsolescence was a question of degree and so a question of fact (at p 210). Rowlatt J did, however, set out a few general comments on obsolescence, stating that (at p 210):

> There is always the possibility – and this is what I think the Commissioners may have thought; so far as I can see, they did think – that the Company here merely wanted something rather better, not because the old thing had been superseded by improvements, but they wanted rather a better ship, because it would suit their purposes better. The old ship and the new ship are both contemporary types of ships as far as that goes, but they wanted rather a better one because they thought it would be more useful for the way they were going to carry on their business, and that is all: and I think under those circumstances, it is open to the Commissioners to say the plant has not become obsolete.

36. By stating that both of the ships were contemporary types of ships, Rowlatt J left open the possibility that technological changes may cause obsolescence and may, objectively, contribute to a decrease in the estimated useful life of the item. In this case, however, the fact that there were more superior vessels (such that replacement made business sense) did not prove that the old ship had been "superseded by improvements". Rowlatt J therefore found that the old ship had not become obsolete.

Obsolescence must affect the state or nature of the item by decreasing that item's estimated useful life, but obsolescence is not wear and tear

37. The Commissioner considers that a relevant consideration in deciding whether an item is affected by obsolescence is whether the item will remain adequate for the purpose or function for which it was acquired. If the cause of the claimed obsolescence will result in the item being no longer suitable for the purpose or function for which that item was acquired then it is more likely that the item will be affected by obsolescence. In *South Metropolitan Gas Company* the purpose or function of the taxpayer's steamship remained unchanged from when that steamship was purchased. Therefore, obsolescence was not relevant. Each case must be considered on its own facts to determine whether there has been a decrease in the estimated useful life of an item or whether the

decrease is caused by other considerations, such as the taxpayer's desire to increase business.

38. In *Para Handkerchief*, Jaine J stated that the loss in value, caused by an asset becoming obsolete or useless, must be related to the state or nature of the assets (at p 9,129):

> Section 108 was hardly designed to allow an almost complete write-off of near new assets in the first year (when the Commissioner has already allowed standard depreciation for that year) when there can be no suggestion that their income producing capabilities had been affected except by the business failure of the owner brought about by factors unrelated to the state or nature of the assets.

39. Therefore, obsolescence must be related to the state or nature of an item by causing a decrease in the estimated useful life of the item. However, that does not require that the item is obsolete or useless to everyone. In both *Para Handkerchief* and *South Metropolitan Gas Company* the items did not suffer from a decrease in their estimated useful life. In *Para Handkerchief* the decrease in value was caused by business failure, and in *South Metropolitan Gas Company* the taxpayer merely wished to replace a steamship with a superior vessel and was therefore not obsolete.

40. In *Robertson* the taxpayer claimed deductions for various items of plant purchased to replace items the taxpayer had sold or scrapped or that had become worn out. Murray CJ stated that wear and tear was not the same as obsolescence (at p 318):

> Advancing age or obsolescence of the thing it [sic] not "wear and tear" …; and *Earl of Derby v. Aylmer*, [1915] K.B. 374; *London County Council v. Edwards*, (1909) 100 L.T. 444, at p. 446.

41. This conclusion would be the same under s EE 63. This is because the term "wear and tear" and the term "obsolescence" are listed separately as factors that may be used in determining an item's estimated useful life under s EE 63(1)(a). In *Para Handkerchief* Jaine J discussed *Robertson*, stating (at p 9,131):

> The judgments in *Robertson*, and in particular the conclusion that useless means unfit through wear and tear and that the item is *either* incapable of repair *or* in a condition that would lead a reasonable businessman to replace, need to be considered in the context of the particular statutory provisions with which they were dealing.
>
> The indication by *Napier* J that "useless" means "useless for the purposes of the trade or business" cannot be said to mean simply "useless for the purposes of the trade or business of the taxpayer" without further qualification. The provision he was interpreting did not require (as s 108 does) the taxpayer to satisfy the Commissioner that the state of uselessness could not be made good by repair. In that context he appears merely to be saying that if it is commercially expedient to cease using an asset which has suffered from wear and tear for the purposes of the taxpayer's business *and* the taxpayer incurs expense in substituting a new asset, a deduction may be allowed in respect of some part of the cost of the new equipment.
>
> The position was expressed by *Murray* CJ at p 319 in the following way:
>
> > "… an implement is 'useless' from wear and tear, within the meaning of the provision, when it has become unfit for the purpose for which it was used and is either incapable of being repaired or is in such a condition that a reasonable businessman would prefer to substitute a new implement rather than incur the cost of repairing the old one."
>
> In the present case there is of course no question of commercial expediency leading to replacement of equipment which had suffered wear and tear but neither could it possibly be said on the facts in the present case that the assets were useless for the purposes of the trade or business carried on by the company. They remained commercially useful as evidenced by the fact that they were used by the purchaser in the operation of the business until fire brought about its conclusion.

42. Obsolescence under s EE 63 does not require that the item cannot be made good by repair. However, s EE 63(1)(b) does provide that in setting an estimated useful life for an item there is an assumption of normal and reasonable maintenance. Unlike the United Kingdom and Australian decisions set out above, however, s EE 63 is not necessarily intended to promote the purchase of new items as s EE 63 does not require that the item be replaced.

United States case law examples of obsolescence

43. There are some United States decisions that consider the meaning of obsolescence in a depreciation context. However, in the United States cases, the taxpayer is generally claiming a deduction for obsolescence at the end of the item's life. This is in contrast to the New Zealand legislation, in which the estimated useful life of an item (taking into account obsolescence) is used to determine an appropriate depreciation rate to be used throughout the life of the item.

44. In *Anaconda Company v Property Tax Department of the State of New Mexico* 94 NM 202; 608 P 2d 514 (1979), the Court of Appeals in New Mexico discussed the meaning of the term "obsolescence", stating (at p 207; 519):

> **"Obsolescence"** is generally understood to be the process "whereby property, because of causes other than physical deterioration, loses its economic usefulness to the taxpayer" 4 Mertens, Law of Federal Income Taxation

s 23.104 (1973). A broader definition was given by the Massachusetts Supreme Court, which stated that **obsolescence** "mean(s) a loss in the service value of a fixed or capital asset which has become useless or inefficient on account of advances in the art, new inventions, inadequacy, the shifting of business centres, the loss of trade or some governmental ruling" *Attorney DJ General v Trustees of Boston Elevated Railway*, 319 Mass. 642, 659, 67 N.E. 2d 676, 688 (1946). Interpreting a federal statute allowing a deduction from **income tax** for **obsolescence**, the United States Court of Claims stated that in order to obtain the deduction the taxpayer must show that the property is being affected by economic conditions that will result in its being abandoned prior to the end of its normal useful life. *S.S. White Dental Manufacturing Company v. United States* 38 F. Supp. 301, 93 Ct. CL.469 cert. denied, 314 U.S. 644, 62 S.Ct. 84, 86 L.Ed. 517 (1941). (Emphasis added.) Yet not every decision to abandon property gives rise to a claim for **obsolescence**. *Real Estate-Land Title & Trust Co. v United States*, 309 U.S. 13, 60 S.Ct. 371, 84 L.Ed. 542 (1940). [Emphasis in original]

45. As stated in *Anaconda Company* the item must be affected by economic conditions (for example, advances in the art, new inventions, and inadequacy) that will result in the need to abandon the item before the end of its physical life. Obsolescence may exist where an item becomes outmoded by virtue of more modern improved alternatives that make the item uneconomic or uncompetitive, such that it will eventually be replaced.

46. However, obsolescence does not equate to there simply being "better" or more modern alternatives available. Any technological advances or improvements must be significant enough to affect the item's estimated useful life. The item must eventually be "superseded by improvements": *South Metropolitan Gas Company*. This requires a reasonable certainty that the item will become obsolete and a sufficiently clear indication of when this would be likely to occur.

47. Some cases make specific reference to two main forms of obsolescence, being "functional" and "economic" obsolescence. An example is set out in the New York Supreme Court, Appellate Division decision in *Piazza v Town Assessor of Town of Porte* 16 AD 2d 863; 228 NYS 2d 397 (1962) (at p 863; 397):

"Functional obsolescence" with respect to valuation of property for taxation is a loss of value brought about by the failure or inability to deliver full service, and includes any loss of value by reason of shortcomings or undesirable features contained within the property itself and is a loss of utility and failure to function due to inadequacies of design and deficiency in the property.

"Economic obsolescence" with respect to valuation of property for taxation is a loss of value brought about by conditions that environ [surround, enclose] a structure such as a declining location or downgrading of a neighbourhood resulting in reduced business volume.

48. Functional obsolescence primarily considers factors inherent to items that have an effect on the estimated useful life of that item. Such factors include (but are not limited to) technological changes affecting the ability to use an item. An example of a factor inherent to an item that decreases its estimated useful life is new mobile phone technology where there is no longer a provider of the old technology. Any mobile phone using that technology would be rendered obsolete due to the inability to access service.

49. Economic obsolescence primarily considers factors that cause changes to the environment and conditions surrounding an item that have an effect on the estimated useful life of that item. Such factors include (but are not limited to) regulatory or economic changes. For example, government regulation or public taste could change consumer demand for a product produced by an item. As stated above, however, the cause of the obsolescence must objectively contribute to a decrease in the estimated useful life of an item. Economic factors could impact equally on either the supply or demand side of a business. Economic factors (such as supply and demand changes) need careful consideration as a clear link to a decrease in the estimated useful life of an item must be established. This is because, as stated by Jaine J in *Para Handkerchief*, obsolescence is not relevant where the cause of a decrease in value is unrelated to the state or nature of the actual items.

50. The Commissioner considers that an example of economic obsolescence is the depletion of available raw materials that an item relies on to produce income. This is because a lack of raw materials for a machine contributes to the reduced usefulness of that item. In *Anaconda Company* the taxpayer, relying on a valuation report, argued that its uranium supply would be depleted in eight years. However, the claim that the uranium supply would be depleted within eight years was disproved because contrary evidence was called that indicated there was another 11.2 million tonnes of uranium in the area (this information came from a merger report between the taxpayer and another company) and the price of uranium ore was rising. The taxpayer also argued that one of its uranium ore mills was less productive than other independent mills. The taxpayer produced evidence showing that its mill had an 89.2% recovery rate whereas other mills had a 90.9% recovery rate. This evidence was not considered sufficient to overturn the trial court's factual findings that obsolescence was not present in this case.

51. In *Piazza* the New York Supreme Court referred to an argument, by the taxpayer, that economic obsolescence was present because the taxpayer's hospital was in a rural area where an industrial plant had closed, resulting in low business volume. The taxpayer argued that the hospital could not be operated at a profit. The court stated that the taxpayer had failed to produce evidence in support of this argument. However, the High Court decision in *Para Handkerchief* shows that business failure that does not affect the items, is not sufficient for obsolescence to be relevant. This is because the cause of the obsolescence must be objectively shown to affect the estimated useful life of an item.

52. The United States Supreme Court considered the meaning of the term "obsolescence" in *Real Estate-Land Title & Trust Co v United States* 309 US 13 (1940), stating (at p 16):

> This Court, without undertaking a comprehensive definition, has held that obsolescence for purposes of the revenue acts 'may arise from changes in the art, shifting of business centers, loss of trade, inadequacy, supersession, prohibitory laws, and other things which, apart from physical deterioration, operate to cause elements or the plant as a whole to suffer diminution in value' … Such specific examples illustrate the type of "economic conditions" whose effect on physical property is recognized as obsolescence by the Treasury Regulations. Others could be mentioned which similarly cause or contribute to the relentless march of physical property to the junk pile. But in general, obsolescence under the Act connotes functional depreciation, as it does in accounting and engineering terminology. More than use or disuse is necessary to establish it. To be sure, reasons of economy may cause a management to discard a title plant [Facilities – records, equipment, fixtures, and personnel – required to function as a title insurance operation] either where it has become outmoded by improved devices or where it is acquired as a duplicate and therefore is useless. **But not every decision of management to abandon facilities or to discontinue their use gives rise to a claim for obsolescence. For obsolescence under the Act requires that the operative cause of the present or growing uselessness arise from external forces which make it desirable or imperative that the property be replaced.** What those operative causes may be will be dependent on a wide variety of factual situations. "New and modern methods" appear to have been one of the real causes of abandonment of the title plant in *Crooks v. Kansas City Title & Trust Co* … Suffice it hereto say that no such external causes are present, for the record shows little more than the desire of a management to eliminate one plant which was a needless duplication of another but which functionally was adequate. The fact that fewer employees were required to operate the one retained than the one discarded is inconclusive here. For this is not the case of acquisition of a new plant to take the place of one outmoded or less efficient. Rather the conclusion is irresistible that the plant was discarded only as a proximate result of petitioner's voluntary action in acquiring excess capacity.
>
> [Emphasis added]

53. The term "external forces" was used in *Real Estate-Land Title & Trust Co* to refer to the fact that the causes of the obsolescence must be outside the control of the taxpayer (external forces could result in functional obsolescence or economic obsolescence). This means obsolescence does not hinge on the decisions of management that a particular item be abandoned or its use terminated. Therefore, the presence of obsolescence is judged objectively before disposing of the item. The decision in *Real Estate-Land Title & Trust Co* further shows that the external forces cannot merely be the expansion of the business or the desire to expand the business. This is because the expansion of the business or the desire to expand the business, by itself, does not affect the estimated useful life of an item.

54. In the United States Court of Federal Claims decision in *SS White Dental Manufacturing Company v United States* 38 F Supp 301 (1941) the taxpayer consolidated its operations to one of its three manufacturing plants for cost-saving reasons. One of the plants was effectively abandoned, and the taxpayer claimed an allowance for "extraordinary obsolescence". The Court of Claims noted (at p 304):

> The facts clearly indicate that the underlying reason for the abandonment and disposition of the Northwood plant was to save the extra operating costs of maintaining the two plants. The ultimate purpose, as disclosed by the minutes of the directors' meeting and by testimony, was to abandon the third plant also and to consolidate the entire operation at the headquarters plant at Staten Island.
>
> The Northwood plant was adequate. It was located in a desirable industrial centre. It was easily accessible for all purposes. It was in good condition and satisfactory in operation. The primary reason for the decision to consolidate the two plants at Staten Island was that the current expenses of operation could be reduced thereby.

And later (at p 306):

> There is no evidence that any of the buildings were in other than first-class condition. On the contrary, the appraiser's report shows them in good condition.
>
> We find that the evidence fails to show that the physical plant in Northwood on April 1, 1936, was on the way to becoming obsolete. Under the facts as disclosed by the evidence the plaintiff is not entitled to recover on the grounds of obsolescence.

55. An important point in the above extract from *White Dental* is that making a business more efficient by abandoning an item does not necessarily mean the item is affected by obsolescence. Similarly, an item is not necessarily obsolete simply because the item is of no further use to a particular taxpayer in deriving their assessable income. This is because the decrease in utility must relate to the item itself by objectively causing a decrease in the estimated useful life of that item. In this case the estimated useful life of the plant was unchanged and the taxpayer merely wished to consolidate its operations to save costs. Although *White Dental* involved consolidating business premises, the Commissioner also considers that the growth of a business, which reduces the utility of an item, does not, in itself, establish that an item is becoming obsolete.

What the Commissioner takes into account when considering whether an item is affected by obsolescence

56. In the context of s EE 63, obsolescence involves a reduction in the period for which an asset might be expected to be useful in deriving assessable income for reasons (other than physical deterioration or wear and tear) such as economic, technological or other external causes that affect the estimated useful life of the item. The tests for obsolescence are the same regardless of whether the Commissioner is setting a general, special or provisional depreciation rate. However, there may be differences in the types of information available to the Commissioner to determine whether an item is affected by obsolescence. For example, when the Commissioner is considering an application for a special depreciation rate, the Commissioner would have information about the particular circumstances relating to the taxpayer's item. Whereas, in setting a general rate, the Commissioner takes into account information generic to the class of item.

57. The cases discussed above show that determining whether an item is affected by obsolescence is a question of fact to be judged objectively. The cause of any obsolescence will be outside the control of the taxpayer and may arise from factors that are inherent to the item (functional obsolescence) or that constitute a change to the environment or conditions surrounding an item (economic obsolescence).

58. There are many different causes of obsolescence and this statement does not provide an exhaustive list. However, the Commissioner considers that the following are examples of external causes that may result in an item becoming obsolete:

- prohibitory laws or regulatory changes that affect the useful life of the item in deriving assessable income;
- technological changes or the development of more modern improved alternatives that are significant enough to affect the useful life of the item and mean that the item has been superseded by improvements;
- changes in consumer tastes and public opinion, in relation to products produced by the item, such that the item will no longer be useful in deriving assessable income;
- changes in the art or, in other words, changes in the way in which a business or a type of business is undertaken, such that the item's estimated useful life is decreased;
- depletion of raw materials on which the item is reliant to produce income;
- the item causes reduced ability or failure to continue business at previous levels such that the item will no longer be useful in deriving assessable income.

59. An item may become obsolete when it is superseded by improvements. However, obsolescence does not equate to an item simply being suboptimal or there being "better" or more modern alternatives. The difference is that the more modern improved alternatives must be significant enough to affect the estimated useful life of the item. Examples of situations where the items remained suitable for their original use or purpose are the assets in *Para Handkerchief*, the steamship in *South Metropolitan Gas Company* and the surplus Northwood industrial plant in *White Dental*.

60. As discussed above, obsolescence is the process of becoming obsolete. However, it may not always be a gradual process. When the Commissioner sets the estimated useful life for an item of depreciable property any reasonably predictable obsolescence will be taken into account at that time. For obsolescence to be taken into account, the estimated useful life of the item must have decreased. As the obsolescence of an item is a question of fact, other considerations similar to those set out above may also be relevant.

61. The Commissioner considers, however, that the following considerations, by themselves, will not establish whether a decrease in the estimated useful life of an item is as a result of obsolescence:

- demolition, scrapping or abandonment of the item, or a decision to do so;

- a decision of management to discontinue the use of an item;
- the availability of newer or better alternatives;
- market forces of supply and demand;
- a desire to enhance or expand business operations;
- the likelihood of business failure.

Examples

62. The following examples illustrate the principles outlined in this Interpretation Statement. They are therefore only a guide. Whether obsolescence may be taken into account in determining the estimated useful life of an item of depreciable property will depend on the facts of each case.

63. The first five examples consider situations in which an event has occurred (other than physical wear and tear) that may have changed the estimated useful life of the item. The examples then consider whether that event has reduced the original estimated useful life of the depreciable property. The sixth example shows how the Commissioner will take obsolescence into account when setting a general rate.

Example 1

64. The Government contracts A Ltd to provide security at New Zealand's international airports. To provide this service, A Ltd has purchased equipment to scan passengers and their baggage.

65. As a result of world events, the governments around the world have updated their security regulations to require more rigorous screening of passengers and baggage at international airports. As a result of these new security regulations, the New Zealand Government passes legislation to comply with the new international standards. To comply with the legislation, A Ltd must replace all of its existing equipment with new equipment within the next two years. The equipment is incapable of being used for any other purpose.

66. The result of the new legislation is that the equipment will become obsolete at the end of the two-year period and must be replaced. Therefore the current depreciation rate for A Ltd's depreciable property may no longer be appropriate and A Ltd may wish to apply to the Commissioner for a depreciation determination setting new depreciation rates for its equipment.

Example 2

67. B Ltd owns and operates a business producing aluminium. The manufacture of aluminium requires specialist machinery that depends on aluminium ore. New research suggests the amount of aluminium ore available in the country is decreasing faster than was previously estimated. It is not feasible to import aluminium ore. B Ltd's specialist machinery is also not capable of running on any input other than aluminium ore.

68. Once the supplies of aluminium ore have run out, B Ltd's machine will become obsolete. Because the supply of aluminium ore is now decreasing faster than it was initially estimated, the estimated useful life of the plant has decreased and the applicable rates of depreciation (if any) on B Ltd's plant may no longer be appropriate. Therefore, obsolescence will be relevant when setting any applicable depreciation rate for B Ltd's plant.

Example 3

69. C Ltd owns and operates an eye clinic specialising in refractive surgery for correcting myopia, hyperopia, and astigmatism. New technological developments result in a new type of refractive surgery, which requires new machinery. The existing machinery remains adequate for the job for which it was acquired, but C Ltd has had a dramatic decrease in the number of customers because the public now demand surgery using the new machinery. This increase in demand is the result of media coverage highlighting the improvements in the new type of refractive surgery.

70. The Commissioner considers that this is an example of consumer preferences causing C Ltd's machine to become obsolete. This means the applicable rates of depreciation on C Ltd's machinery may no longer be appropriate. Therefore, C Ltd may wish to apply to the Commissioner for a depreciation determination setting new depreciation rates for its machinery.

Example 4

71. D Ltd owns and operates a small winery business. D Ltd's wine is very popular, so the owners wish to expand the business. D Ltd gains consent to undertake a total redevelopment and expansion of the winery, complete with much larger wine vats, so production can be increased.

72. D Ltd argues that the current winery is now obsolete because the market for wine has changed and it can no longer produce enough wine to keep up with customer orders. D Ltd also argues that if it did not expand, its customers might lose interest in its product. For this reason D Ltd considers that the previous depreciable property used by the winery (for example, the smaller wine vats) has been affected by obsolescence.

73. The decision by D Ltd to expand the winery is a result of D Ltd's desire to expand its business or, in other words, because of the increased demand for D Ltd's product. The change in customer preferences and expectations did not have any impact on the estimated useful life of any of D Ltd's depreciable property used before the redevelopment and expansion of the winery (for example, the smaller wine vats). This is because the wine-making equipment used before the redevelopment remains able to undertake the function for which that equipment was designed. Therefore, none of the winery's depreciable property has been affected by a change in circumstances leading to a decrease in the estimated useful life of that depreciable property. Therefore, the current depreciation rates for D Ltd's depreciable property remain appropriate.

Example 5

74. E Ltd owns and operates a business renting buses to the public. Some of E Ltd's buses have diesel engines, and those buses are all five years old with an estimated useful life of another seven years. New research shows that these types of diesel engines in buses, when they are over 10 years old, are extremely harmful to the environment. As a result, the Government decides to pass new environmental emissions laws for buses with this type of engine over 10 years old. These new laws mean E Ltd's buses with diesel engines that are over 10 years old are not allowed to be registered to be driven on the road.

75. The effect of the new law is that the estimated useful life of these diesel engine buses of E Ltd has been decreased from 12 years to 10 years. The Commissioner considers that this is an example of economic obsolescence, such that the applicable rate of depreciation on E Ltd's buses with this type of engine may no longer be appropriate. Therefore, E Ltd may wish to apply to the Commissioner for a depreciation determination setting new depreciation rates for these buses.

Example 6

76. The Commissioner is considering setting a general economic depreciation rate for game consoles with hard drives. Game consoles are basically computers that are specifically designed to be used to play video games. These items are used in a number of different types of businesses such as hotels and short-term hire companies.

77. Game consoles are subject to technological change and are regularly superseded by improvements in later generation models. Often games for later models cannot be played on earlier models. In addition, there is evidence that consumer demand means that earlier generation consoles cannot be hired out. It is accepted that the useful life of the consoles would be significantly shorter than their physical life due to technological change and consumer demand. The Commissioner therefore considers that video game consoles will be affected by obsolescence and their estimate useful life would be reduced accordingly. In setting the final estimated useful life, in addition to obsolescence there may be other factors to take into account such as wear and tear.

NEW LEGISLATION

TAXATION (CANTERBURY EARTHQUAKE MEASURES) ACT 2011

The Taxation (Canterbury Earthquake Measures) Bill was introduced into Parliament on 4 May 2011 and contained measures to deal with taxation issues arising from the earthquakes that occurred on 4 September 2010 and 22 February 2011 in the Canterbury region. The bill was passed under urgency on 19 May 2011, with the resulting Act receiving Royal assent on 24 May 2011.

The new Act amends the Income Tax Act 2007, Tax Administration Act 1994, Estate and Gift Duties Act 1968 and the Taxation (Budget Measures) Act 2010.

TAX RELIEF FOR EMPLOYERS' WELFARE CONTRIBUTIONS TO EMPLOYEES

Sections CZ 23, CZ 24 and YA 1 of the Income Tax Act 2007

Changes included in the Taxation (Canterbury Earthquake Measures) Act 2011 provide an exemption for certain welfare contributions made by an employer to employees as a result of the two major Canterbury earthquakes. The exemption may be applied to:

- accommodation;
- "sundry" fringe benefits when the employer cannot reasonably estimate which employees received which benefits; and
- the first $3,200 per earthquake of monetary remuneration and fringe benefits of the kind where the employer can reasonably be expected to know which employees received which benefits.

Background

Under existing tax law (with a few limited exclusions), payments made from an employer to an employee and fringe benefits provided to an employee are taxable, either as monetary remuneration or by way of fringe benefit tax (FBT).

Following the major Christchurch earthquakes of 4 September 2010 and 22 February 2011, a number of employers made ex gratia welfare contributions of cash or benefits to their earthquake-affected employees. Several requests were made asking that these contributions not be subject to taxation.

On 28 March 2011, the Minister of Finance and the Minister of Revenue released details of changes to tax legislation agreed to by Cabinet, including three inter-linked tax exemptions for employers and their employees for earthquake-related employer welfare contributions.

Key features

Income tax exemption

New section CZ 23 of the Income Tax Act 2007 provides that income (which could include accommodation benefits) derived by an employee from an employer is exempt income if:

- it was provided by the employer for the purpose of relief of employees from the adverse effects of the Canterbury earthquakes of 4 September 2010 or 22 February 2011, as defined in section 4 of the Canterbury Earthquake Recovery Act 2011;
- it would otherwise have been taxable income;
- it was derived in the eight weeks after each of these earthquakes;
- it was not paid as a substitute for wages or salary;
- the amount provided does not depend on the seniority of the employee;
- the employee is associated with the employer, it was also available to an unrelated full-time employee; and
- the employer elects to treat the income as being exempt income of the employee.

Extent of the exemption

All accommodation benefits defined in section CE 1(2) (Amounts derived in connection with employment) are exempt.

In relation to each of the two major earthquakes, the first $3,200 paid to each employee, other than accommodation benefits, is also exempt.

Fringe benefit tax exemption

New section CZ 24 of the Income Tax Act 2007 provides that benefits received by an employee from an employer are exempt from FBT if:

- it was provided by the employer to employees for the purpose of relief of employees from the adverse effects of the Canterbury earthquakes of 4 September 2010 or 22 February 2011, as defined in section 4 of the Canterbury Earthquake Recovery Act 2011;
- it would otherwise have been a fringe benefit;

- it was received by the employee in the eight weeks after each of these earthquakes;
- it was not provided in substitution for wages and salary;
- its provision and amount does not depend on the seniority of the employee;
- the employee is associated with the employer, it was also available to an unrelated full-time employee; and
- the employer elects to treat the benefit as not being a taxable benefit.

Extent of the exemption

All "sundry benefits" are exempt, for example, benefits that were provided at a drop-in centre. Often, if not always in this case, an employer would have no idea which employee had received what benefits. Accordingly, if the employer cannot estimate the value of these benefits provided to each employee, they are treated as exempt.

If the employer can estimate the value of a benefit that an employee has received in relation to one of the two earthquakes, it will be exempt FBT to the extent that the $3,200 employee exemption for that earthquake has not been used to exempt employee income.

The election

The employer makes the elections by taking or amending a filing position.

Application date

These amendments are treated as coming into force on 4 September 2010.

WORKING FOR FAMILIES: FAMILY SCHEME INCOME – "OTHER PAYMENT" CATEGORY

Section MB 13 of the Income Tax 2007 and section 91AAS of the Tax Administration Act 1994

The "other payments" category in the definition of "family scheme income" has been amended to ensure payments given to support people affected by events such as the Canterbury earthquakes in September 2010 and February 2011, and other similar events in the future, are excluded from the definition of family scheme income for up to 12 months.

Background

The Taxation (GST and Remedial Matters) Act 2010 introduced a more comprehensive definition of "family scheme income". This new definition of family scheme income applies for Working for Families (WFF) tax credits, and community services cards for those with dependent children, from 1 April 2011. The definition will also be used for student allowance parental income test purposes when the necessary regulations are made

People adversely affected by the Canterbury earthquakes have received payments from relatives and employers to help them to recover from the earthquakes, replace damaged items and meet everyday living expenses. Under the new definition of family scheme income, these payments could be potentially included in family scheme income, affecting the recipient's entitlements to various benefits, including WFF tax credits.

Key features

The Taxation (Canterbury Earthquake Measures) Act 2011 allows for payments given to support people adversely affected by the Canterbury earthquakes, and similar events in the future, to be excluded from the definition of family scheme income.

Section MB 13(2) of the Income Tax Act 2007 has been amended so that payments made to relieve the adverse effects of emergency events declared by the Commissioner are excluded from the "other payment" category in the family scheme income definition for a specified period of up to 12 months.

New section 91AAS of the Tax Administration Act 1994 authorises the Commissioner to make a determination declaring an event, which meets the requirements of paragraphs (a) and (b) of the definition of "emergency" in section 4 of the Civil Defence Emergency Management Act 2002, an emergency event for family scheme income purposes. The requirements of these paragraphs generally relate to a state of emergency caused by natural disasters. The determination must also specify an application period of up to 12 months from the date of the event.

The Commissioner's determinations in relation to the Canterbury earthquakes are included in this issue of the *Tax Information Bulletin*.

Application date

The amendments come into force on 1 April 2011.

EXTENSION OF THE REDUNDANCY TAX CREDIT

Subpart ML, sections MA 1, ML 1, ML 2 and YA 1 of the Income Tax Act 2007 and section 95 of the Taxation (Budget Measures) Act 2010

As part of Budget 2010, the redundancy tax credit was cancelled with effect for redundancies after 30 September 2010, the date that the 33% tax rate applied from. Following the 4 September 2010 earthquake, this was

reconsidered and cancellation was delayed so that it applied to redundancies after 31 March 2011.

As a consequence of the 22 February 2011 earthquake, the cancellation of the redundancy tax credit has been further delayed so that it will now apply to redundancies after 30 September 2011. If the redundancy is on or before 30 September 2011, the tax credit will apply according to subpart ML.

On 1 April 2012 subpart ML, the section YA 1 redundancy definition and the section MA 1 reference will be repealed.

Application dates

The extension is treated as coming into force on 1 April 2011, the previous date of cancellation.

The cancellation is effective 30 September 2011, and the relevant legislation is itself repealed on 1 April 2012.

TAX RELIEF FOR DONATED TRADING STOCK

Section GZ 3 of the Income Tax Act 2007 and section 73B of the Estate and Gift Duties Act 1968

The new legislation provides tax relief for businesses that have made, or are contemplating making, donations (or supplies for less than market value) of trading stock for relief from the Canterbury earthquakes.

Changes introduced in the new Act provide that:

- an anti-avoidance rule applying to disposals of trading stock at below market value does not apply to disposals of trading stock by a person to a person who is not an associated person for the purpose of relief from the adverse effects of a Canterbury earthquake in the period beginning on 4 September 2010 and ending on 31 March 2012; and
- a gift by a person to a person who is not an associated person shall not constitute a dutiable gift if the gift is of trading stock, and made for the purpose of relief from the adverse effects of a Canterbury earthquake, and made within the period beginning on 4 September 2010 and ending on 31 March 2012.

Background

Generally (with a few limited exclusions), a person who disposes of trading stock for no consideration, or an amount that is less than the market value of the trading stock at the time of disposal, is treated as deriving an amount equal to the market value of the trading stock at the time of disposal.

Gift duty is also payable on dutiable gifts made by a person if they exceed an aggregate value of $27,000 in a 12-month period. For gift duty purposes, a gift is something given, other than by will, when the person making the transfer (the donor) does not receive fully adequate consideration in money or money's worth.

Following the Christchurch earthquake on 22 February 2011, public calls were made to Ministers and officials seeking legislation to provide tax relief for donated goods, especially trading stock donated by businesses.

On 28 March 2011, the Minister of Revenue and the Minister of Finance released details of proposed changes to tax legislation agreed to by Cabinet, including an exemption so that businesses do not have to pay tax or gift duty on trading stock they have donated within four months of either the 4 September 2010 or 22 February 2011 Canterbury earthquakes.

In response to feedback received following this announcement, Cabinet agreed to extend the eligible period for the tax relief so that it covered the period beginning on 4 September 2010 and ending on 31 March 2012.

Key features

Donations of trading stock for relief of Canterbury earthquakes

New section GZ 3 of the Income Tax Act 2007 provides that section GC 1 (Disposals of trading stock at below market value) does not apply to the disposal of trading stock by a person to a person who is not an associated person:

- for the purpose of relief from the adverse effects of a Canterbury earthquake, as defined in section 4 of the Canterbury Earthquake Recovery Act 2011; and
- in the period beginning on 4 September 2010 and ending on 31 March 2012.

The meaning of "trading stock" in new section GZ 3 is that contained in section EB 2 of the Income Tax Act 2007.

Exemption for certain gifts of trading stock

New section 73B of the Estate and Gift Duties Act 1968 provides that a gift by a person to another person who is not associated under the Income Tax Act 2007 will not be subject to gift duty if the gift is:

- of trading stock as defined in section EB 2 of the Income Tax Act 2007;
- made for the purpose of relief from the adverse effects of a Canterbury earthquake, as defined in section 4 of the Canterbury Earthquake Recovery Act 2011; and
- made within the period beginning on 4 September 2010 and ending on 31 March 2012.

Application date

The application date for the changes providing tax relief for donated trading stock is 4 September 2010.

TAXATION (ANNUAL RATES AND BUDGET MEASURES) ACT 2011

The Taxation (Annual Rates and Budget Measures) Bill was introduced under urgency on 19 May 2011 and received Royal assent on 24 May 2011. The new Act gives effect to tax reforms announced in Budget 2011 to reduce the fiscal costs of KiwiSaver and Working for Families tax credits. The Act also sets the annual rates for income tax for the 2011–12 tax year.

The Act amends the Income Tax Act 2007 and the KiwiSaver Act 2006.

WORKING FOR FAMILIES TAX CREDITS

Sections MD 13 and MF 7 of the Income Tax Act 2007

The Taxation (Annual Rates and Budget Measures) Act 2011 introduced a number of amendments that affect the calculation of Working for Families (WFF) tax credits.

There are three parts to the amendments to the WFF tax credits:

- The rate at which WFF tax credits are abated will increase by 1.25 percentage points every time the Family Tax Credit (FTC) amounts are increased for inflation, until the abatement rate reaches 25%. The first abatement rate increase will occur on 1 April 2012 when the first inflation increase under section MF 7(2) of the Income Tax Act 2007 applies.
- The threshold at which WFF tax credits begin to abate will decrease from $36,827 to $36,350 on 1 April 2012. The threshold will continue to decrease by $450 each subsequent time the FTC amounts are increased for inflation, until the threshold reaches $35,000.
- The FTC amounts for children aged 16 and over will no longer be increased for inflation until the FTC amounts for the eldest child under 16 or for subsequent children aged 13 to 15 equals the respective 16 and over amounts. At this point subsequent increases for inflation will apply.

Background

Under the previous rules, WFF tax credits (excluding the Minimum Family Tax Credit) abated at the rate of 20 cents in the dollar from an abatement threshold of $36,827. When a person's annual income exceeds this threshold, the WFF tax credits are abated—FTC is abated first, followed by the In-Work Tax Credit and then the Parental Tax Credit.

The amounts of FTC prescribed in section MD 3(4) of the Income Tax Act 2007 are adjusted for inflation. The inflation adjustment ensures that the real value of assistance is maintained over time. The adjustment occurs once the cumulative increase in the Consumers Price Index (CPI) reaches 5% from the last adjustment. The last adjustment was on 1 October 2008.

The next inflation adjustment will occur on 1 April 2012 because 5% cumulative inflation was breached in December 2010. The size of the adjustment will not be known until the September 2011 CPI is published, which is used for calculating the amount by which the FTC is indexed. The amount will be the cumulative CPI from September 2008 to September 2011, and will exclude the 2.02% increase in FTC on 1 October 2010, which is consistent with sections MF 7(1), (2) and (2B) of the Income Tax Act 2007.

Key features

The policy objective of the WFF amendments is to reduce the fiscal costs of the scheme while protecting amounts of tax credits for lower income earners, and minimising the effects on work incentives.

The end result is for WFF tax credits to abate at a rate of 25% from a threshold of $35,000, with one amount of FTC for the eldest child and two amounts of FTC for subsequent children, for 0–12 years and 13 and over.

This result is achieved by staggering the increase in the abatement rate, the decrease in the abatement threshold and the alignment of amounts of FTC over time so the impact on families is gradual, while still generating fiscal savings.

Section MD 13(3)(a) has been amended so that:

- in the first inflation adjustment round on 1 April 2012, the abatement rate increases from 20% to 21.25% and the abatement threshold decreases from $36,827 to $36,350;
- in the second inflation adjustment round, the abatement rate increases from 21.25% to 22.5% and the abatement threshold decreases from $36,350 to $35,900;
- in the third inflation adjustment round, the abatement rate increases from 22.5% to 23.75% and the abatement threshold decreases from $35,900 to $35,450; and
- in the fourth inflation adjustment round, the abatement rate increases from 23.75% to 25% and the abatement threshold decreases from $35,450 to $35,000.

These changes to the abatement rate and threshold mean that entitlements to WFF tax credits reduce faster and sooner as income increases. These changes will come into force when inflation adjustment rounds are required by section MF 7(2) of the Income Tax Act 2007.

Section MF 7(1)(a) has been amended so that the prescribed FTC amounts for children 16 years and over in sections MD 3(4)(a)(ii) and (b)(iii) are no longer adjusted for inflation until FTC amounts for the eldest child under 16 or for subsequent children aged 13 to 15, equals the respective 16-year and over amount. At this point the older and younger child amounts are aligned by Order in Council and subsequent increases for inflation apply. This change simplifies the FTC, leaving one rate (rather than two) for a first child and two rates (rather than three) for subsequent children.

Application dates

The amendments come into force at the same time as the inflation adjustment rounds required by section MF 7(2) of the Income Tax Act 2007. The first inflation adjustment round will take effect on 1 April 2012.

KIWISAVER

Sections MK 4, RD 5, RD 65 to 67, RD 69, YA 1 and schedule 1 of the Income Tax Act 2007

The new legislation introduces changes to member tax credits (MTC) and the taxation of employer superannuation contributions.

Key features

- The maximum amount of MTC has been reduced to $521.43 per year for the year ended 30 June 2012 and following years.
- The rate at which the MTC is paid is reduced to 50c for each $1 contributed by individual KiwiSaver members (or members of complying superannuation funds), for the year ended 30 June 2012 and following years.
- The exemption from employer's superannuation contribution tax (ESCT) for employer's superannuation cash contributions (up to 2 percent of salary and wages) to employees' KiwiSaver and complying superannuation fund accounts is removed from 1 April 2012.
- ESCT deducted from employer's superannuation cash contributions to any superannuation fund (not just KiwiSaver funds) must be calculated at a rate equivalent to an employee's marginal tax rate from 1 April 2012. The current default deduction rate (a flat rate of 0.33) is removed.

Note: An increase in the default and minimum employee contribution rate and the compulsory employer contribution rate (from 2% to 3%) were also announced in Budget 2011. These higher contribution rates do not take effect until 1 April 2013; this deferred application date meant it was not necessary, for implementation reasons, to include these changes in the Taxation (Annual Rates and Budget Measures) Act 2011. The necessary legislation will be included in a taxation bill scheduled to be introduced in September 2011.

Application dates

- The reduced MTC maximum amount and MTC payment rate apply for MTCs paid for the year ended 30 June 2012 and following years.
- The removal of the ESCT exemption and the calculation of ESCT at a rate equivalent to an employee's marginal tax rate applies from 1 April 2012.

Detailed analysis

Member tax credits

Member tax credits are designed to encourage regular saving by members into their KiwiSaver account, or complying superannuation fund.

MTCs are paid each year to eligible members until they are able to withdraw their savings. An eligible member must be aged 18 or over and they must have either a principal place of residence in New Zealand, or else be an overseas employee of the State services, or working overseas as a charity volunteer.

The MTC amount is calculated in relation to a member's credit contributions over an annual period, starting on 1 July each year. MTCs are claimed by, and paid to, KiwiSaver providers or complying superannuation funds on behalf of their members; claims are usually made by providers after 1 July each year for the preceding MTC year.

For the MTC year ended 30 June 2012 and for following MTC years:

- The maximum amount of MTC paid per member is reduced to $521.43.
- The rate at which the member tax credit is paid is reduced to 50c for each $1 contributed by members.
- This means that in order to receive the maximum MTC of $521.43, a member will need to contribute $1,042.86 per year.

MTC claims relating to years ending on or before 30 June 2011 are not affected by these current changes. For these MTC years:

- The maximum MTC amount payable for a year is $1,042.86.
- The amount of MTC paid for the year is matched to member contributions for that year, dollar for dollar, up to the maximum MTC amount.

Employer superannuation contribution tax

Cash contributions made by an employer to a superannuation fund for the benefit of an employee are generally liable for employer superannuation contribution tax (ESCT).

ESCT is deducted from an employer's superannuation cash contribution.

Removal of exemption of KiwiSaver and complying superannuation funds

Compulsory employer contributions to KiwiSaver schemes and complying superannuation funds were previously exempted from ESCT.

This exemption is removed from 1 April 2012. ESCT will therefore need to be deducted on compulsory employer contributions to KiwiSaver and complying superannuation funds.

ESCT rate

The ESCT flat rate of 0.33 cent has been removed as a default rate. The removal of the default flat rate applies to employer's superannuation cash contributions made to all defined contribution superannuation funds, not just KiwiSaver funds.

ESCT must be deducted at an annual ESCT rate based on either:

- the annual salary or wages plus gross employer contributions paid to the employee in the previous standard tax year (if the employee was employed for all of that year); or
- an estimate of the total amount of salary or wages plus gross employer contributions that the employee will earn in the year ahead (where the employee was not employed for all of the previous tax year).

The annual ESCT rates are available from the Inland Revenue website **www.ird.govt.nz**

Employees and employers can still agree to treat the employer superannuation contribution as salary or wages, in which case the PAYE rules will apply instead.

ANNUAL INCOME TAX RATES FOR 2011–12 TAX YEAR

The annual income tax rates for the 2011–12 tax year are specified in schedule 1 of the Income Tax Act 2007.

ORDER IN COUNCIL

FBT RATE FOR LOW-INTEREST LOANS FALLS

The prescribed rate of interest used to calculate fringe benefit tax on low-interest, employment-related loans is 5.90%, down from the previous rate of 6.24% which applied from the quarter beginning 1 October 2010.

The new rate applies for the quarter beginning 1 April 2011.

The rate is reviewed regularly to align it with the results of the Reserve Bank's survey of variable first-mortgage housing rates.

The new rate was set by Order in Council on 30 May 2011.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2011 (SR 2011/192)

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.

RECEIVERS LIABLE TO RETURN AND PAY GST ON MORTGAGEE SALE

Case	Simpson and Downes as receivers of Capital + Merchants Investments Ltd (in receivership) v Commissioner of Inland Revenue
Decision date	17 May 2011
Act(s)	Goods and Services Tax Act 1985
Keywords	Receivers, mortgagee sale, GST, special return, caveat, liability

Summary

Messrs Simpson and Downes, as receivers of Capital + Merchants Investments Ltd (in receivership), were personally liable to account to the Commissioner for the output tax on mortgagee sales.

Impact of decision

The Court affirmed a purposive approach to the interpretation of tax statutes.

A receiver of a mortgagee must personally account to the Commissioner for any output tax on any mortgagee sales and, it appears, must file the special return required by s 17 of the Goods and Services Tax Act 1985 (GST Act) as the person "selling the goods".

Facts

On 18 December 2006 Capital + Merchants Investments Limited (CMI) entered into a general security agreement in favour of Fortress Credit Corporation (Fortress) over all the assets of CMI. These assets included loans to five different borrowers, secured by mortgages over six properties.

After CMI defaulted on its obligations to Fortress, Richard Simpson and Tim Downes of Grant Thorton were appointed receivers ("the Receivers") of CMI on 23 November 2007. There were instances of default by the mortgagors and the Receivers exercised the powers of sale contained in the mortgages. CMI's indebtedness exceeded the gross realisation of all assets including the proceeds of the mortgagee sales.

GST was charged on each mortgagee sale. CMI completed s 17 of the GST Act special returns but did not pay the output tax returned in those returns.

Decision

Having traversed the factual background, the Court turned to consider the approach to the interpretation of taxing statutes. Having considered the Supreme Court decision in *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue*, the Court concluded that both judgments (the minority and majority) in *Ben Nevis* recognised the appropriateness of a purposive interpretation to specific taxing statutes.

The Court then went on to consider s 5(2) of the GST Act and determined that the evident purpose of the subsection is to address the consequences of supplies occurring where the owner has granted security and the secured creditor effects the supply of the goods to a third party (ie, the secured creditor realises his/her/its security).

The aim of the provision is to match a buyer's entitlement to an input credit against the seller's obligation to account for output tax on the sale. To facilitate this matching, s 5(2) deems supplies in the name of the secured creditor to be supplies by the mortgagor. The critical element is not the identity of the person empowered to sell, but the identity of the person practically responsible for the power of sale being exercised.

The Court found that, were it necessary, it would be prepared to consider adopting the wider interpretation of s 5(2) that in circumstances such as the present, receivers would have standing as the "second person" where they exercised commercial and practical control over the transaction involving a taxable supply.

The Court, however, went on to determine the case on the basis of ss 17 and 58(1A) of the GST Act.

Section 17 imposes an obligation to file a special return on the "person selling the goods", whether or not the person is registered. The Court considered that it is a "fair assumption" that Parliament imposed this obligation because of an expectation that the person completing the return and effecting the sale will be the person who has received the consideration for the supply, including the GST.

The Court considered it relevant that caveats were lodged by Fortress on the properties and that Fortress purported to make it a condition of providing releases of the caveats that it be paid all monies available from the mortgagee sale, including any amounts paid by the purchaser in relation to GST. However, CMI as the mortgagee was only entitled to the net proceeds of the mortgagee sale after the payment of all expenses (which include GST, see *Edgewater v Commissioner of Inland Revenue*). Fortress could not assert any claim greater than that of CMI, which it was purporting to do by making the release of the caveats conditional on payment of all monies including the GST.

The Court went on to consider the further argument of the Commissioner that the Receivers were personally liable under common law and the equitable doctrine of the duty to account.

The Court accepted that, in public policy terms, it is undesirable to permit receivers to charge GST and pay that GST to their appointer (Fortress) when the mortgagee (CMI) would be required to pay the GST as an expense of sale to the Commissioner (*Edgewater*). This would demonstrate an indifference to the consequences for CMI (mortgagee) of being found in breach of obligations to account for the GST. The prospect of abuse of the provisions of the GST Act by engineering a receivership for the sake of the GST premium on recoveries in such situations and the equivalent cost to Inland Revenue could not be lightly dismissed.

The Court, however, was reluctant to impose a liability on the Receivers merely as a matter of public policy. The Court went on to consider, with it being inappropriate to attempt any definitive ruling without further evidence and argument, that there may be a credible cause of action against the Receivers in tort for having procured or been a party to a breach of a statutory duty.

Ultimately, the Court did not need to reach a decision that the Receivers were personally liable on these grounds as it had already found the Receivers liable under ss 5(2), 17 and 58 of the GST Act.

The Court concluded that the answer to the Receivers' application for directions was that they are liable to account to the Commissioner for the GST charged as an output tax on the respective sales of the relevant properties.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Legal and Technical Services

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

Legal and Technical Services also contribute to the "Your opportunity to comment" section.

Policy Advice Division

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

Litigation Management

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

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

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