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CONTENTS

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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
ED0146	Draft standard practice statement: Late filing penalty	This draft SPS updates and replaces SPS 05/01: *Late filing penalty*. It clarifies the imposition of late filing penalties for GST purposes as set out in section 139AAA of the Tax Administration Act 1994 effective from 1 April 2008 imposes late filing penalties for not filing GST returns by the due date.	30 March 2012
ED0143	Draft standard practice statement: Recording Inland Revenue interviews	This draft SPS sets out Inland Revenue's standard practice for recording interviews electronically.	31 March 2012
ING0016	Goods and services tax; income tax – "sham"	This interpretation guideline contains the Commissioner's view on the law on sham. The essential characteristic of a sham is pretence. A sham exists where the parties intend the transaction documents to mislead third-parties as to the true nature of the relationship between the parties. The guideline sets out the meaning of sham, when sham can be alleged, how the courts determine whether this is a sham, and the consequences of a finding of sham.	
QWB0095	Fringe benefit tax – "availability" benefits	This question we've been asked considers the question: "If an employer makes a good or service available to an employee to enjoy, will the mere availability of the good or service be a fringe benefit?".	
INS0119	Income tax – deductibility of expenditure incurred in borrowing money – sections DB 5 and DA 1	This interpretation statement considers the application of s DB 5 (which provides for the deductibility of expenditure incurred in borrowing money for use as capital in deriving income). It also considers the relationship between s DB 5 and the financial arrangements rules, and when borrowing costs may be deductible under s DA 1 (the general deductibility provision).	

INS0120	Income tax – deductibility of repairs and maintenance expenditure – general principles	This interpretation statement considers the deductibility of costs incurred by a taxpayer to repair or maintain their property. It replaces and updates (but does not materially alter) the Commissioner's earlier general statement on repairs and maintenance published in *Tax Information Bulletin* Vol 5, No 9 (February 1994).	
The following items were previously published in the *Public Information Bulletin* (PIB). They have been identified as still relevant by the PIB Review and are required to be republished.			
QWB0103	Income tax – deductibility of expenditure on stock yards	This question we've been asked updates and replaces part of the item "Allowances on Covered Stock Yard", published in *Public Information Bulletin* No 21 (April 1965) p 10, that relates to the cost of fencing new stock yards. This QWBA sets out the Commissioner's view on the deductibility of expenditure incurred on the construction of stock yards.	
QWB0105	Income tax – Deductibility of expenditure on widening or metalling a farm access road or track	This question we've been asked updates and partly replaces the item "Expenses Allowable To Farmers Who Convert To Tanker Collection" published in *Public Information Bulletin* No 20 (March 1965) p 11. The item relates to the expenses allowable to farmers who convert to tanker collection. This QWBA sets out the Commissioner's view on the deductibility of expenditure on the widening and/or metalling of an existing farm road.	
QWB0104	Income tax – deductibility of expenditure on cattle stops	This question we've been asked updates and replaces the parts of the item "Expenses Allowable to Farmers Who Convert To Tanker Collection" that relate to cattle stops, published in *Public Information Bulletin* No 20 (March 1965) p 11. This QWBA sets out the Commissioner's view on the deductibility of expenditure incurred on the construction of a cattle stop.	

IN SUMMARY

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Adjudication & Rulings: A guide to binding rulings (IR 715)* or pages 1–6 of the *TIB* Vol 6, No 12 (May 1995) or pages 1–3 of Vol 7, No 2 (August 1995). You can download these publications free from our website at **www.ird.govt.nz**

PRODUCT RULING BR PRD 11/06: ST LUKES GROUP LTD

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the person who applied for the Ruling

This Ruling has been applied for by St Lukes Group Limited.

Taxation Law

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

This Ruling applies in respect of ss 5(11D)–(11I) and 8.

The Arrangement to which this Ruling applies

The Arrangement is the provision of the electronic gift card scheme (Westfield Gift Card scheme) whereby customers can purchase Westfield Gift Cards and the card holders can redeem them for goods and services supplied by the participating stores and, on limited occasions, by the applicant.

Further details of the Arrangement are set out in the paragraphs below.

Details of the Arrangement

Parties to the Arrangement

1. The Arrangement involves:
   - the applicant: St Lukes Group Limited, being the provider of the Westfield Gift Card scheme and the owner of Westfield Gift Cards;
   - participating stores: the stores within Westfield shopping malls in which card holders may redeem the Westfield Gift Cards for goods or services;
   - card holders: people who hold a Westfield Gift Card and are entitled to receive goods or services on the redemption of the gift card;
   - customers: people who purchase a Westfield Gift Card; they may not be the same people as the card holders if they allow another person to use or take possession of the Westfield Gift Card.
2. The applicant and all participating stores are "registered persons" (as defined in s 2(1)).
3. The Westfield Gift Card scheme will operate as described in paragraphs 4 to 22.

Terms and conditions documented

4. A detailed description of the terms and conditions of the Westfield Gift Card is set out in two documents (which are not materially different to the copies of these documents attached to the ruling application dated 16 May 2011):
   - *Gift Card Terms and Conditions (In-Store)*, for in-store gift card purchases;
   - *Gift Card Terms and Conditions (Online)*, for online gift card purchases.

Purchase of gift cards

5. A customer will be able to purchase a Westfield Gift Card from a Customer Services Desk in a Westfield shopping mall or online through the Westfield website. Additionally, participating stores as agents on behalf of the applicant may sell Westfield Gift Cards.

Value of gift cards

6. On the purchase of the Westfield Gift Card, the customer may load a value from $10 to $995 on to the card. The funds loaded on to the card are transferred into a trust bank account. Interest accumulating on the funds held in trust will be payable to the applicant.
7. The value loaded on the Westfield Gift Card may then be used to purchase goods and services at participating stores within the Westfield network or from the applicant in limited situations. Purchases cannot be made online.

Fees and surcharges

8. In addition to the amount loaded on to the Westfield Gift Cards, a fee may be charged for each Westfield Gift Card, accompanying greeting card and envelope.

9. Under the *Gift Card Terms and Conditions (Online)*, when payment for a Westfield Gift Card purchased online is to be made by Diners Club, American Express, Visa or MasterCard, the applicant reserves the right to charge customers a surcharge, imposed by card companies and banks.

Gift cards cannot be topped up but can be combined

10. At present, Westfield Gift Cards will not be able to be topped up or added to after they have been purchased. However, if a card holder has several Westfield Gift Cards with differing values, the card holder may ask for a new Westfield Gift Card to be issued that combines all the card balances. A fee may be charged for the issue of the new card in this instance.

Value may be printed or handwritten on gift cards

11. Bulk orders of Westfield Gift Cards are often ordered by corporate customers (who may want to distribute the cards as gifts to their customers or employees). In this case, the initial value loaded will be printed on the Westfield Gift Cards. For individual customer Westfield Gift Card orders, the initial value loaded will usually be handwritten on the cards.

Balance of gift cards can be checked

12. Card holders can check their Westfield Gift Card balances at any time:
    - at a website;
    - by text;
    - by phoning;
    - by asking at any Customer Services Desk in a Westfield shopping centre.
13. A cost of 50 cents per message will be chargeable when a card holder sends a text message to check the Westfield Gift Card balance.

Expiry of gift cards

14. Westfield Gift Cards expire 12 months after their purchase. Any balance remaining on a Westfield Gift Card after its expiry date will become the property of the applicant.

Gift cards may be used with alternative payment options

15. If a card holder does not have sufficient funds on the Westfield Gift Card to purchase an item, the card holder may pay using both the gift card balance plus an alternative payment option (ie, cash, credit card or EFTPOS).

Gift cards are not redeemable for cash and are not legal tender

16. Westfield Gift Cards cannot be redeemed for cash.
17. Westfield Gift Cards are not legal tender, account cards, credit or debit cards, or securities.

Applicant incurs the scheme's operating costs

18. The applicant will incur costs in relation to the operation of the Westfield Gift Card scheme, including transaction fees from the processing of gift cards at retailer terminals. These fees include third-party maintenance costs (eg, server hosting fees, licensing and system monitoring and transaction fees for activating and replacing cards) along with the costs of setting up and running the software required to manage the scheme. Costs also include ongoing costs such as the printing costs of the cards and the envelopes sold.
19. The applicant may make limited supplies. For example, Westfield Gift Cards may be used to purchase bus tickets from Westfield information centres, but this is estimated to be less than 1% of the total goods and services acquired by card holders using the gift cards.

Participating stores will honour gift cards

20. The applicant has agreed with the participating stores that the participating stores will honour a Westfield Gift Card, if a card holder presents the card before its expiry date. This is a condition of the lease agreement.

Lost or stolen gift cards may be replaced

21. If a Westfield Gift Card is faulty or has been lost or stolen, the applicant will provide a replacement card of the same value as the unused value and with the expiry date as for the original Westfield Gift Card. For lost and stolen Westfield Gift Cards, card holders must provide an original receipt and card number. A fee may be charged for the issue of the replacement card.

Applicant owns the gift cards

22. The Westfield Gift Card remains the property of the applicant.

Scope of this Ruling

23. This ruling does not cover the GST implications of:
    - the cost of 50 cents per text message that is charged to a card holder when they send a text message to check the Westfield Gift Card balance;
    - any re-charge to customers of bank or credit card company surcharges when customers purchase the Westfield Gift Cards online.

Assumptions made by the Commissioner

This Ruling is made subject to the following assumptions:

- The applicant (the Lessor) and the participating stores (the Lessee) enter into an agreement (generally by way of lease), which includes the following matters (or words to this effects):
  - The administration of electronic gift cards is reliant on EFTPOS/Credit Card facilities;
  - With the agreement of the Lessor, where a Lessee has no electronic EFTPOS/Credit card facilities the lessee will not be obliged to honour electronic gift cards;
  - The electronic gift cards may only be used by a customer for the full or partial purchase of the Lessee's goods or services;
  - No cash or credit notes may be issued by the Lessee for balances remaining on electronic gift cards;
  - The Lessor will pay to the Lessee by way of cheque, direct credit or in cash, that part of the value of the transaction that a customer uses an electronic gift card to purchase the Lessee's goods or services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) The applicant is, at all times, the supplier of the Westfield Gift Cards to the customers for the purposes of s 5(11G).

(b) The applicant and the participating stores agree that a supply for GST purposes occurs when a Westfield Gift Card is used to acquire goods or services and not when the Westfield Gift Card is issued or sold.

How the Taxation Law applies to the Arrangement

Subject in all respects to any assumption or condition stated above, the Taxation Law applies to the Arrangement as follows:

- Under s 5(11G), any goods and services supplied by the participating stores on redemption of Westfield Gift Cards will be treated by the applicant as a supply of goods and services for GST purposes. Accordingly, the participating stores are required to charge card holders GST and account for GST output tax when goods and services are acquired by the card holders using the Westfield Gift Cards.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 2 November 2011 and ending on 30 November 2014.

This Ruling is signed by me on the 2nd day of November 2011.

Tracey Lloyd
Acting Assurance Manager

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.

SPECIAL DETERMINATION S19: MANDATORY CONVERSION CONVERTIBLE NOTES WITH CONSUMER PRICE INDEX ADJUSTMENTS TO FACE VALUE

This Determination may be cited as Special Determination "S19: Mandatory conversion convertible notes with consumer price index adjustments to face value".

1. Explanation (which does not form part of the determination)

1. This Determination relates to mandatory conversion convertible notes (MCNs) to be issued by ABC Company (Issuer) a wholly owned special purpose subsidiary of DEF Company (the Shareholder) to XYZ Company (the Noteholder).
2. The MCNs constitute financial arrangements in respect of which the Noteholder provides funds to the Issuer, with the debt to be discharged at a future date by the issue of Noteholder Shares in the Issuer to the Noteholder. The face value of the MCNs will increase or decrease in line with the All Groups Consumers Price Index (CPI) as measured and published by Statistics New Zealand. Coupon Interest will be paid (in cash) on the Adjusted Face Value of the MCNs, in the period between the issue of the MCNs and the conversion of the MCNs into Noteholder Shares.
3. An amount (whether it is income, gain, loss or expenditure) that is solely attributable to an excepted financial arrangement (as described in ss EW 5(2) to EW 5(16) of the Income Tax Act 2007) is not taken into account under the Financial Arrangements Rules (in accordance with s EW 6(2)).
4. As a share is an excepted financial arrangement under s EW 5(13) of the Income Tax Act 2007, only the Coupon Interest and the CPI Adjustment (provided condition 5(d) of the Deed Poll is not invoked) will be regarded as income or expenditure under the Financial Arrangements Rules. Any fluctuation in the market value of the Noteholder Shares will be disregarded.
5. This Determination prescribes the method to be used by the Issuer when calculating the aggregate income derived or aggregate expenditure incurred in respect of the MCNs under the Financial Arrangements Rules. It details which amounts are to be included for this calculation and which are attributable to an excepted financial arrangement.

2. Reference

1. This Determination is made pursuant to s 90AC(1)(bb) of the Tax Administration Act 1994.

3. Scope of determination

1. This Determination applies only to the MCNs described as follows:
   a) The Issuer will borrow money from the Noteholder by issuing a MCN to the Noteholder. The amount borrowed will be $100 million. The face value of the MCNs will adjust quarterly in line with the All Groups CPI using the calculation set out in Schedule 1 of the Deed Poll. If Statistics New Zealand ceases to publish the All Groups CPI, the appropriate replacement index or base, as set out in the definition of "Index" in Schedule 1 of the Deed Poll, will be used in place of the All Groups CPI.
   b) The MCNs will pay Coupon Interest of 4% per annum (payable monthly, in arrears) on the Adjusted Face Value of the MCNs, provided that doing so does not breach the solvency test (under the Companies Act 1993) or any other legal obligation of the Issuer, or if the Noteholder is in default. If the solvency test or other legal obligation of the Issuer is breached, or if the Noteholder is in default, interest payments will be suspended. However, interest will continue to accrue at the Default Interest Rate if the suspension is due to either of the first two of the above events. "Default Interest Rate" is defined as the Coupon Interest rate (which is 4% for the original term and 5% where the term of the MCNs is extended) plus 1% per annum. If an Event of Default (as defined in condition 8 of the Deed Poll) occurs, interest will accrue at the Default Interest Rate. The Noteholder will also have the option to require the Issuer to redeem the MCNs.

c) The MCNs will carry the same voting rights as those attaching to the Shareholder Shares.

d) After 10 years, where condition 5(d) of the Deed Poll has not been invoked, and where the Adjusted Face Value of the MCNs is equal to, or less than, the value of the Shareholder Shares, the MCNs will convert into Noteholder Shares with a value equal to the Shareholder Shares held by the Shareholder. The Noteholder and the Shareholder will then each have 50% of the shares in the Issuer.

e) After 10 years, where condition 5(d) of the Deed Poll has not been invoked, and where the Adjusted Face Value of the MCNs is more than the value of the Shareholder Shares, the Issuer may elect to extend the term of the MCNs by 3 years. Where this occurs, the Coupon Interest will increase to 5% and the MCNs will convert on the Replacement Conversion Date.

f) If condition 5(d) of the Deed Poll has not been invoked, and the Adjusted Face Value of the MCNs is more than the value of the Shareholder Shares, whether the term of the MCNs has been extended (as described in paragraph 3(1)(e) above) or not, the Shareholder may subscribe for additional Shareholder Shares under condition 5(b) of the Deed Poll. This involves the Shareholder subscribing for additional Shareholder Shares in the Issuer. The purchase of the additional Shareholder Shares will provide funds to the Issuer, all of which must be used by the Issuer to repay part of the Adjusted Face Value of the MCNs owing to the Noteholder. This subscription increases the Shareholder's shareholding, while at the same time reducing the value of the Noteholder Shares that the Noteholder is entitled to receive on conversion. The value of the share purchase by the Shareholder is such that on conversion of the remainder, the Noteholder and the Shareholder will each have 50% of the shares in the Issuer.

g) The Noteholder will be entitled to appoint 50% of the board of directors of the Issuer. If the Noteholder's Directors vote against a recommendation made by the property manager and supported by the Shareholder appointed directors (except where that recommendation relates to front loading, or involves a transaction between the Shareholder and a related company), and such vote is ratified by the Noteholder then condition 5(d) of the Deed Poll may be invoked. If condition 5(d) is invoked, the Noteholder will lose its right, on conversion, to receive Noteholder Shares to the value of the Adjusted Face Value of the MCNs. In this event, on the Conversion Date, or Replacement Conversion Date (as the case may be), the Issuer will issue to the Noteholder Shares equal to the number of Shareholder Shares on issue to the Shareholder on the Conversion Date.

4. Principle

1. The MCNs have both debt and equity components. They can be regarded alternatively as:
   a) a loan to the Issuer with repayment in shares (debt component); or
   b) a forward purchase of shares (in which case the holder of the MCNs is buying shares in a company and has equity in it).
2. As the MCNs have this dual character, when calculating income or expenditure in relation to the MCNs it is first necessary to separate the debt and equity components of the MCNs.
3. This Determination specifies that the Coupon Interest and (where condition 5(d) of the Deed Poll has not been invoked) the CPI Adjustment, relate to the debt component of the MCNs. Changes in the value of the Noteholder Shares relate to the equity component and will be excluded from the application of the Financial Arrangements Rules when calculating income or expenditure for the Issuer.
4. This Determination specifies that if condition 5(d) of the Deed Poll is invoked then, from the date the condition is invoked, only the Coupon Interest will relate to the debt component of the MCNs. If condition 5(d) is invoked then the CPI Adjustment and any changes in the value of the Noteholder Shares will relate to the equity component and will be excluded from the application of the Financial Arrangements Rules when calculating income or expenditure for the Issuer. Further, any income or deductions already returned or claimed for the CPI Adjustments must be reversed (see paragraph 6(9) of this determination below).
5. For the purposes of this Determination any change in the market value of the Noteholder Shares between the issue date of the MCNs and the conversion of the MCNs into shares is solely attributable to the equity component of the MCNs. Therefore, the difference in Noteholder Share price can be ignored when calculating income and expenditure.

5. Interpretation

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

a) "Adjusted Face Value" means the initial face value of the MCNs together with the quarterly CPI adjustments to the face value of the MCNs.

b) "Financial Arrangements Rules" means the rules referred to in section YA 1 and EW 1(2) of the Income Tax Act 2007.

c) "Coupon Interest" means the cash interest amounts paid on a monthly basis by the Issuer to the Noteholder pursuant to the terms of the Deed Poll.

d) "CPI Adjustment" means the quarterly adjustments to the face value of the Notes pursuant to the terms of the Deed Poll.

e) Noteholder Shares in relation to the MCNs means the fully paid ordinary shares in the Issuer to be issued on conversion of the MCNs.

f) "Shareholder Shares" means the fully paid ordinary shares in the Issuer held by the Shareholder, including any additional shares subscribed for under condition 5(b) of the Deed Poll.

6. Method

1. When calculating the aggregate income or aggregate expenditure with regard to the MCNs, the income, gain, loss, expenditure or any other consideration receivable by the Noteholder or payable by the Issuer will be:

   a) where condition 5(d) of the Deed Poll has not been invoked during the term of the MCNs:

      i) the Coupon Interest; and

      ii) the CPI Adjustment.

   b) where condition 5(d) of the Deed Poll is invoked during the term of the MCNs, from that date, only the Coupon Interest.

2. The amount to be attributed to the CPI Adjustment is the net amount by which the face value of the MCNs increases or decreases over the term of the MCNs.

3. If condition 5(d) of the Deed Poll has not been invoked during the term of the MCNs:

   a) where the face value of the MCNs increases, the CPI Adjustment shall be expenditure; or

   b) where the face value of the MCNs decreases, the CPI Adjustment shall be income.

4. If condition 5(d) of the Deed Poll is invoked during the term of the MCNs, from that date, the CPI Adjustment will cease to be either expenditure or income. In this situation, any income or deduction already returned or claimed for the CPI Adjustment must be reversed (see paragraph 6(9) of this determination below).

5. All other income, gains, losses or expenditure in relation to the MCNs is solely attributable to the excepted financial arrangement component of the MCNs.

6. The Coupon Interest payment and the CPI Adjustment (as applicable) will be spread over the term of the MCNs as follows:

   a) in respect of Coupon Interest, the amount to be attributed to an income year during which the MCNs are on issue will be the total of all interest expenditure incurred in the relevant income year. For example, for the income year ending 30 June 2012, this will include all interest payments falling due for payment up to and including the payment to be made on 1 July 2012.

   b) in respect of the CPI Adjustment, where condition 5(d) of the Deed Poll has not been invoked, the amount to be attributed to an income year during which the MCNs are on issue will be the amount by which the face value of the MCNs increases or decreases in respect of months falling within that income year. For example, for the income year ending 30 June 2012, this will include the CPI Adjustments made up to and including the CPI Adjustment to be made on 1 July 2012. This net amount of the CPI Adjustment will either be expenditure (where it increases) or income (where it decreases) for that income year.

   The Issuer is an International Financial Reporting Standards (IFRS) taxpayer. At the time that the MCNs are issued, the above method will be consistent with an IFRS financial reporting method (provided that condition 5(d) of the Deed Poll is not invoked during the term of the MCNs).

7. For the purposes of the base price adjustment, the amount of the consideration that has been paid to the Issuer for the MCNs (based on the definition of "consideration" in s EW 31(7) of the Income Tax Act 2007) is the amount subscribed for the MCNs with no part of the consideration being attributable to the excepted financial arrangement component of the MCNs.

8. If condition 5(d) of the Deed Poll has not been invoked, for the purposes of the base price adjustment, the amount of the consideration that will be paid by the Issuer for the MCNs by way of the issue of Noteholder Shares (based on the definition of "consideration" in s EW 31(7) of the Income Tax Act 2007) is equal to the Adjusted Principal Amount (which includes the CPI Adjustments).

9. If condition 5(d) of the Deed Poll has been invoked, the Issuer will complete a calculation applying the method in Determination G25 in the income year in which the condition is invoked so that the CPI Adjustments treated as income or expenditure to date are reversed in that income year.
10. If condition 5(d) of the Deed Poll has been invoked, for the purposes of the base price adjustment calculated at maturity of the MCNs, the amount of the consideration that will be paid by the Issuer for the MCNs by way of the issue of Noteholder Shares (based on the definition of "consideration" in s EW 31(7) of the Income Tax Act 2007) is equal to the amount that was paid by the Noteholder to the Issuer for the MCNs.

7. Examples

Example A: Adjusted Principal Amount is greater than the value of the Shareholder's shares

1. This example illustrates the application of the method (set out in this Determination) for determining the amounts attributable to both the debt and equity components of the MCNs to be issued by the Issuer to the Noteholder.
2. The example assumes the following:
   - The MCNs are issued on 1 July 2011 and the Noteholder will continue to hold the MCNs until 30 June 2021, when the MCNs will mandatorily convert into shares in the Issuer.
   - The amount subscribed for the MCNs is $100 million.
   - The CPI, for all relevant quarters, is 2% per annum.
   - Interest payments are not suspended during the term of the MCNs.
   - On conversion, the Adjusted Principal Amount will be less than the total value of the Issuer's assets.
   - On conversion, the Adjusted Principal Amount will be greater than the total value of the Shareholder's Shares.
   - Condition 5(d) of the Deed Poll has not been invoked.
3. The Issuer will be allowed deductions for expenditure arising under the Financial Arrangements Rules during the term of the MCNs. This expenditure is in the form of the CPI Adjustments and the coupon interest payments. The expenditure for the first two income years, for which deductions will be allowed, is set out in the table in Appendix 1 (the deductions will continue on this basis during the term of the MCN). It is noted that the CPI Adjustments will be deductible whether paid in the form of shares only or a combination of shares and cash (where the Shareholder subscribes for additional shares and the Issuer uses the funds raised to redeem part of the MCNs prior to the MCNs being converted to Noteholder Shares).
4. Any other amounts will be attributable to the equity component of the MCNs.
5. The base price adjustment required for the 2021 income year will be as follows:

Example A		
Consideration		
Paid/payable to the Issuer		100,000,000.00
Less paid/ payable by the Issuer	100,000,000.00	
Total CPI Adjustment*	21,472,063.33	
Total interest	44,157,430.48	
		165,629,493.81
Consideration		–65,629,493.81
Less income		0.00
Plus expenditure		
CPI Adjustment	19,072,689.04	
Total interest	39,334,852.73	
Total expenditure		58,407,541.77
Plus amount remitted		0.00
Base price adjustment		**–7,221,952.04**

Notes:

A deduction will be available to the Issuer in the 2021 tax year of $7,221,952.04 (which is the current year's coupon interest and CPI Adjustment).

* The initial investment plus the total CPI Adjustment will equal the Adjusted Principal Amount.

Example B: Adjusted Principal Amount is equal to or less than the value of Shareholder's Shares

1. This example proceeds on the same basis as Example A, except that on conversion, the Adjusted Principal Amount will be equal to, or less than, the total value of the Shareholder's Shares.
2. The deductions allowed are the same as in Example A.
3. The base price adjustment is the same as in Example A.
4. All other amounts will be attributable to the equity component of the MCNs. In particular (and this is the point of this example), the difference between the value of the Noteholder Shares and the Adjusted Principal Amount will be attributable to the equity component of the MCNs.

Example C: Extension of term

1. This example proceeds on the same basis as Example A, except that the Issuer elects to extend the term of the MCNs by 3 years (as contemplated by the Deed Poll).
2. The Issuer will be allowed deductions in the same way as described in Example A except that the coupon interest will be calculated at a higher rate for the period after the extension. The expenditure during the 3-year extension period, for which deductions will be allowed, is set out in the table in Appendix 2.
3. As with Example A, all other amounts will be attributable to the equity component of the MCNs.
4. The base price adjustment required if the period is extended will be as follows:

Example C		
Consideration		
Paid/payable to the Issuer		100,000,000.00
Less paid/ payable by the Issuer	100,000,000.00	
Total CPI Adjustment*	28,964,194.40	
Total interest	62,980,811.38	
		191,945,005.78
Consideration		−91,945,005.78
Less income		0.00
Plus expenditure		
CPI Adjustment	26,416,831.95	
Total interest	56,580,737.65	
Total expenditure		82,997,569.60
Plus amount remitted		0.00
Base price adjustment		**−8,947,436.18**

Notes:

A deduction will be available to the Issuer for the 2024 tax year of $8,947,436.18 (which is the current year's coupon interest and CPI Adjustment).

* The initial investment plus the total CPI Adjustment will equal the Adjusted Principal Amount.

This Determination is signed by me on the 10th day of October 2011.

MA Smith
Chief Tax Counsel

APPENDICES

Appendix 1: Expenditure for the first two income years

Interest period	Interest payment date	Principal amount	CPI Adjustment	New principal amount	Interest (4%)	CPI Adjustment plus interest	Annual cumulative total
Jul-11	1-Aug-11	100,000,000.00			338,797.81	338,797.81	338,797.81
Aug-11	1-Sep-11	100,000,000.00			338,797.81	338,797.81	677,595.63
Sep-11	1-Oct-11	100,000,000.00			327,868.85	327,868.85	1,005,464.48
Oct-11	1-Nov-11	100,000,000.00	500,000.00	100,500,000.00	340,491.80	840,491.80	1,845,956.28
Nov-11	1-Dec-11	100,500,000.00			329,508.20	329,508.20	2,175,464.48
Dec-11	1-Jan-12	100,500,000.00			340,491.80	340,491.80	2,515,956.28
Jan-12	1-Feb-12	100,500,000.00	502,500.00	101,002,500.00	342,194.26	844,694.26	3,360,650.55
Feb-12	1-Mar-12	101,002,500.00			320,117.21	320,117.21	3,680,767.76
Mar-12	1-Apr-12	101,002,500.00			342,194.26	342,194.26	4,022,962.02
Apr-12	1-May-12	101,002,500.00	505,012.50	101,507,512.50	332,811.52	837,824.02	4,860,786.04
May-12	1-Jun-12	101,507,512.50			343,905.23	343,905.23	5,204,691.27
Jun-12	1-Jul-12	101,507,512.50			332,811.52	332,811.52	5,537,502.79
2012 income year – total expenditure under the financial arrangements rules							*5,537,502.79*
Jul-12	1-Aug-12	101,507,512.50	507,537.56	102,015,050.06	346,571.68	854,109.24	854,109.24
Aug-12	1-Sep-12	102,015,050.06			346,571.68	346,571.68	1,200,680.92
Sep-12	1-Oct-12	102,015,050.06			335,391.95	335,391.95	1,536,072.86
Oct-12	1-Nov-12	102,015,050.06	510,075.25	102,525,125.31	348,304.54	858,379.79	2,394,452.65
Nov-12	1-Dec-12	102,525,125.31			337,068.91	337,068.91	2,731,521.55
Dec-12	1-Jan-13	102,525,125.31			348,304.54	348,304.54	3,079,826.09
Jan-13	1-Feb-13	102,525,125.31	512,625.63	103,037,750.94	350,046.06	862,671.68	3,942,497.77
Feb-13	1-Mar-13	103,037,750.94			316,170.63	316,170.63	4,258,668.41
Mar-13	1-Apr-13	103,037,750.94			350,046.06	350,046.06	4,608,714.46
Apr-13	1-May-13	103,037,750.94	515,188.75	103,552,939.69	340,448.02	855,636.78	5,464,351.24
May-13	1-Jun-13	103,552,939.69			351,796.29	351,796.29	5,816,147.53
Jun-13	1-Jul-13	103,552,939.69			340,448.02	340,448.02	6,156,595.55
2013 income year – total expenditure under the financial arrangements rules							*6,156,595.55*

Appendix 2: Expenditure in the extended period

Interest period	Interest payment date	Principal amount	CPI Adjustment	New principal amount	Interest (5%)	CPI Adjustment plus interest	Annual cumulative total
Jul-21	1-Aug-21	121,472,063.33	607,360.32	122,079,423.65	518,419.47	1,125,779.79	1,125,779.79
Aug-21	1-Sep-21	122,079,423.65			518,419.47	518,419.47	1,644,199.26
Sep-21	1-Oct-21	122,079,423.65			501,696.26	501,696.26	2,145,895.52
Oct-21	1-Nov-21	122,079,423.65	610,397.12	122,689,820.77	521,011.57	1,131,408.69	3,277,304.20
Nov-21	1-Dec-21	122,689,820.77			504,204.74	504,204.74	3,781,508.95
Dec-21	1-Jan-22	122,689,820.77			521,011.57	521,011.57	4,302,520.52
Jan-22	1-Feb-22	122,689,820.77	613,449.10	123,303,269.87	523,616.63	1,137,065.73	5,439,586.24
Feb-22	1-Mar-22	123,303,269.87			472,944.05	472,944.05	5,912,530.29
Mar-22	1-Apr-22	123,303,269.87			523,616.63	523,616.63	6,436,146.92
Apr-22	1-May-22	123,303,269.87	616,516.35	123,919,786.22	509,259.40	1,125,775.74	7,561,922.66
May-22	1-Jun-22	123,919,786.22			526,234.71	526,234.71	8,088,157.37
Jun-22	1-Jul-22	123,919,786.22			509,259.40	509,259.40	8,597,416.77
2022 income year – total expenditure under the financial arrangements rules							8,597,416.77
Jul-22	1-Aug-22	123,919,786.22	619,598.93	124,539,385.15	528,865.88	1,148,464.81	1,148,464.81
Aug-22	1-Sep-22	124,539,385.15			528,865.88	528,865.88	1,677,330.70
Sep-22	1-Oct-22	124,539,385.15			511,805.69	511,805.69	2,189,136.39
Oct-22	1-Nov-22	124,539,385.15	622,696.93	125,162,082.08	531,510.21	1,154,207.14	3,343,343.53
Nov-22	1-Dec-22	125,162,082.08			514,364.72	514,364.72	3,857,708.25
Dec-22	1-Jan-23	125,162,082.08			531,510.21	531,510.21	4,389,218.46
Jan-23	1-Feb-23	125,162,082.08	625,810.41	125,787,892.49	534,167.76	1,159,978.17	5,549,196.63
Feb-23	1-Mar-23	125,787,892.49			482,474.11	482,474.11	6,031,670.74
Mar-23	1-Apr-23	125,787,892.49			534,167.76	534,167.76	6,565,838.50
Apr-23	1-May-23	125,787,892.49	628,939.46	126,416,831.95	519,521.23	1,148,460.69	7,714,299.19
May-23	1-Jun-23	126,416,831.95			536,838.60	536,838.60	8,251,137.79
Jun-23	1-Jul-23	126,416,831.95			519,521.23	519,521.23	8,770,659.02
2023 income year – total expenditure under the financial arrangements rules							8,770,659.02
Jul-23	1-Aug-23	126,416,831.95	632,084.16	127,048,916.11	538,048.69	1,170,132.85	1,170,132.85
Aug-23	1-Sep-23	127,048,916.11			538,048.69	538,048.69	1,708,181.54
Sep-23	1-Oct-23	127,048,916.11			520,692.28	520,692.28	2,228,873.82
Oct-23	1-Nov-23	127,048,916.11	635,244.58	127,684,160.69	540,738.93	1,175,983.51	3,404,857.33
Nov-23	1-Dec-23	127,684,160.69			523,295.74	523,295.74	3,928,153.07
Dec-23	1-Jan-24	127,684,160.69			540,738.93	540,738.93	4,468,892.00
Jan-24	1-Feb-24	127,684,160.69	638,420.80	128,322,581.49	543,442.63	1,181,863.43	5,650,755.43
Feb-24	1-Mar-24	128,322,581.49			508,381.81	508,381.81	6,159,137.24
Mar-24	1-Apr-24	128,322,581.49			543,442.63	543,442.63	6,702,579.87
Apr-24	1-May-24	128,322,581.49	641,612.91	128,964,194.40	528,541.78	1,170,154.69	7,872,734.56
May-24	1-Jun-24	128,964,194.40			546,159.84	546,159.84	8,418,894.40
Jun-24	1-Jul-24	128,964,194.40			528,541.78	528,541.78	8,947,436.18
2024 income year – total expenditure under the financial arrangements rules							*8,947,436.18*

SPECIAL DETERMINATION S20: CONVERTIBLE REDEEMABLE NOTES AND PREFERENCE SHARES

This Determination may be cited as Special Determination "S20: Convertible Redeemable Notes and Preference Shares".

1. Explanation (which does not form part of the determination)

1. This Determination relates to convertible redeemable notes (CRNs) issued by Company A (Issuer) to Company B (Noteholder), and to Preference Shares issued by Company C.
2. The CRNs are perpetual debt securities in respect of which the Noteholder loans funds to the Issuer. Coupon Interest will be paid (in cash) on the Principal Amount of the CRNs until the CRNs are redeemed or converted. The Issuer may redeem the CRNs in cash for the Principal Amount plus the Cash Redemption Premium. Alternatively, the Issuer may convert the CRNs to ordinary shares by issuing Conversion Shares in repayment of the Principal Amount, being a fixed number of ordinary shares in the Issuer.
3. It was expected at issue that the CRNs would become an expensive form of funding over time, as the Interest Rate increases. As the Cash Redemption Premium increases over time, there is an increasing economic incentive for the Issuer to convert the CRNs to Conversion Shares rather than redeem them for cash.
4. The Issuer used the Principal Amount to subscribe for Preference Shares in Company C.
5. An amount (whether it is income, gain, consideration, loss or expenditure) that is solely attributable to an excepted financial arrangement (as described in ss EW 5(2) to EW 5(16) of the Income Tax Act 2007) is not taken into account under the financial arrangements rules (in accordance with s EW 6(2)).
6. This Determination prescribes a method for determining the part of the consideration receivable by the parties to the arrangement that is solely attributable to the excepted financial arrangements.

2. Reference

1. This Determination is made pursuant to s 90AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

1. This Determination applies to a wider financial arrangement constituted by:
   a) the CRNs;
   b) the Preference Shares; and
   c) the Conversion Shares.

4. Principle

1. The CRNs, the Preference Shares and the Conversion Shares are each part of a wider financial arrangement that has "excepted financial arrangement" components as defined in s EW 5 of the Income Tax Act 2007. The excepted financial arrangements are:
   a) the Preference Shares; and
   b) the Conversion Shares.
2. The CRNs are a hybrid financial arrangement which have a debt and an equity component. The equity component arises from the option available to the Issuer to issue the Conversion Shares to the Noteholder in lieu of repayment in cash (of the Principal Amount plus the Cash Redemption Premium).
3. As the CRNs have this dual character, when calculating income or expenditure in relation to the CRNs it is first necessary to separate the debt and equity components of the CRNs. For the purposes of this determination it is assumed that, if the Issuer issues Conversion Shares to the Noteholder in lieu of payment of the Principal Amount in cash, any difference between the market value of the Conversion Shares and the Principal Amount is solely attributable to the Conversion Shares. Consequently, the difference is solely attributable to an excepted financial arrangement.
4. Any income, consideration, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement is not included when calculating income or expenditure under the financial arrangements rules.
5. This Determination specifies that the amounts that are solely attributable to the excepted financial arrangements are:
   a) the amounts paid under or with respect to the Preference Shares; and
   b) if the Issuer issues Conversion Shares to the Noteholder in lieu of payment in cash, any difference between the market value of the Conversion Shares and the Principal Amount.

6. This Determination specifies that no part of the Principal Amount, the repayment of the Principal Amount, the Coupon Interest, and any Cash Redemption Premium under the CRNs is solely attributable to an excepted financial arrangement.

5. Interpretation

1. In this Determination, unless the context otherwise requires, words and expressions which have not been defined elsewhere within the determination have the same meaning as in s YA 1 of the Income Tax Act 2007.
2. In this Determination, the following expressions (which have not been defined elsewhere in this Determination) have the following meanings:
   a) "Cash Redemption Premium" means any amount paid by the Issuer to the Noteholder in excess of the Principal Amount on redemption of the CRNs for cash. If the CRNs are redeemed for cash under clause 4.5(b)(ii) of the Terms and Conditions, the Cash Redemption Premium is 2% if the CRNs are redeemed on or before 31 December 2011, 4% if the CRNs are redeemed from 31 December 2011 but on or before 31 December 2012, 6% if the CRNs are redeemed from 31 December 2012 but on or before 31 December 2013, then it continues to increase by a further 2% for each successive two-yearly Interest Rate reset period (as stated in clause 4.2(b)(ii) of the Terms and Conditions).
   b) "Conversion Shares" means a fixed number of fully paid ordinary shares in the Issuer issued to the Noteholder pursuant to clause 4.3 of the Terms and Conditions, after making any adjustment required pursuant to clause 5 of the Terms and Conditions. Pursuant to clause 4.3, the $1 Principal Amount of each CRN will convert to 2.1 fully paid ordinary shares in the Issuer.
   c) "Coupon Interest" means quarterly interest payments by the Issuer to the Noteholder pursuant to clause 3 of the Terms and Conditions, and includes any amount of unpaid interest which is subsequently paid pursuant to clause 3.2(b) of the Terms and Conditions.
   d) "Interest Rate" means 8% until 31 December 2011, and subsequently the rate determined under clause 3.5 of the Terms and Conditions. Under clause 3.5 the interest rate is: from 31 December 2011 until 31 December 2013, a two-year interbank swap rate on 31 December 2011 plus a margin of 550 basis points; from 31 December 2013 until 31 December 2015 a two-year interbank swap rate on 31 December 2013 plus a margin of 650 basis points; and from 31 December 2013 reset at a two-year interbank swap rate plus a margin of 650 basis points every two years (while the CRNs remain on issue).
   e) "Preference Shares" means preference shares in Company C which the Issuer subscribed for in accordance with clause 2.2 of the Subscription Agreement for Convertible Redeemable Notes between the Issuer and the Noteholder, or any such shares that are reclassified as ordinary shares.
   f) "Principal Amount", in relation to each CRN, means $1. References to the aggregate Principal Amount are to the aggregate of the Principal Amount of all the CRNs, being an aggregate Principal Amount of approximately NZ$32.5 million.
   g) "Terms and Conditions" means the CRN terms set out in Schedule 1 to the Subscription Agreement for Convertible Redeemable Notes between the Issuer and the Noteholder.

6. Method

1. Where the CRNs are converted to Conversion Shares pursuant to clause 4.1 of the Terms and Conditions, any amount by which the value of the Conversion Shares is above or below the aggregate Principal Amount of the CRNs is solely attributable to the Conversion Shares.
2. The amounts that are solely attributable to the Preference Shares are:
   a) the issue price per Preference Share of $1;
   b) any dividends paid on the Preference Shares by the Issuer;
   c) any other distributions paid on or with respect to the Preference Shares; and
   d) proceeds derived by the Issuer from the disposal or redemption of the Preference Shares.
3. No other income, gain, loss, expenditure or consideration paid under or with respect to the wider financial arrangement is solely attributable to an excepted financial arrangement component of the wider financial arrangement. Consequently, all other amounts in relation to the CRNs (such as the Principal Amount, Coupon Interest and any Cash Redemption Premium) are taken into account under the financial arrangements rules.

7. Examples

Example A: Value of Conversion Shares exceeds the aggregate Principal Amount

1. This example illustrates the application of the method (set out in this Determination) for determining the amounts attributable to both the debt and equity components of the CRNs to be issued by the Issuer to the Noteholder.
2. The example assumes the following:
    - The CRNs are issued on 16 January 2010 and the Noteholder will continue to hold the CRNs until 31 December 2015.
    - The aggregate Principal Amount subscribed for the CRNs is NZ$32.5 million.
    - The Issuer uses the aggregate Principal Amount to subscribe for Preference Shares in Company C, and derives dividends from them.
    - Coupon Interest payments are not at any time suspended.
    - The Issuer exercises its option to convert the CRNs to Conversion Shares on 31 December 2015.
    - On conversion, the value of the Conversion Shares is NZ$40 million, ie exceeding the aggregate Principal Amount.
3. The Coupon Interest will not be solely attributable to an excepted financial arrangement. Consequently it will be expenditure under the financial arrangements rules.
4. All other income or expenditure will be solely attributable to the excepted financial arrangement components of the wider financial arrangement. Consequently the financial arrangements rules will not apply to such amounts.
5. The difference between the value of the Conversion Shares and the aggregate Principal Amount will be attributable to an excepted financial arrangement, and so will not be income or expenditure under the financial arrangements rules.

Example B: Aggregate Principal Amount is equal to or less than the value of Conversion Shares

1. This example proceeds on the same basis as Example A, except that the value of the Conversion Shares is less than the aggregate Principal Amount.
2. The amounts solely attributable to an excepted financial arrangement are the same as in Example A. Consequently the expenditure under the financial arrangements rules will be the same as in Example A.

Example C: Value of Conversion Shares less than the aggregate Principal Amount

1. This example proceeds on the same basis as Example A, except that the Issuer exercises its option to redeem the CRNs for cash on 31 December 2015.
2. The Coupon Interest and the Cash Redemption Premium equal to 6% of the aggregate Principal Amount payable on redemption will not be solely attributable to an excepted financial arrangement. Consequently these amounts will be expenditure under the financial arrangements rules.

This Determination is signed by me on the 12th day of December 2011.

Howard Davis
Director (Taxpayer Rulings)

LIVESTOCK VALUES – 2012 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2011–2012 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard cost ("NSC") scheme to value any class of specified livestock.

Farmers using the scheme apply the one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm-bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding and rearing rising one-year and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overheads, costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2011 is used while other dairy NSCs are based on survey data to 30 September 2011. For sheep, beef cattle, deer and goats, NSCs are based on survey data from the 2009–2010 year. This is the most recent information available for those livestock types at the time the NSCs are calculated in December 2011.

For the 2011–2012 income year there has been an increase in the NSCs for all livestock types. For sheep and beef cattle this reflects the increase, in real expenditure, of costs incurred per livestock unit. Also impacting on sheep and beef values were improved lambing percentages and an increase in the supply of lambs, and a decreased calving percentage over the previous year.

The increased NSCs for both rising one-year and rising two-year dairy cattle have come about largely because of an increase in costs per livestock unit, together with a slightly lower proportion of rising one-year dairy cattle relative to the cows in milk. The increased NSC for purchased bobby calves is a result of cost increases, especially for feed.

The NSCs for deer, dairy goats, and fibre- and meat-producing goats have all increased because of an increase in real expenditure incurred per livestock unit. An increase in feed cost has driven the increased NSC for pigs.

The NSCs calculated each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self-assessed cost scheme ("SAC") option. SAC is calculated on the same basis as NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2012

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2012".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2011–2012 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007, the national standard costs for specified livestock for the 2011–2012 income year are as set out in the following table.

National standard costs for 2011–2012 income year

Kind of livestock	Category of livestock	National standard cost
Sheep	Rising 1 year	$28.30
	Rising 2 year	$19.80
Dairy Cattle	Purchased bobby calves	$186.70
	Rising 1 year	$473.30
	Rising 2 year	$93.80
Beef Cattle	Rising 1 year	$302.10
	Rising 2 year	$166.70
	Rising 3 year male non-breeding cattle (all breeds)	$166.70
Deer	Rising 1 year	$109.80
	Rising 2 year	$52.80
Goats (meat and fibre)	Rising 1 year	$23.20
	Rising 2 year	$15.90
Goats (dairy)	Rising 1 year	$146.60
	Rising 2 year	$24.40
Pigs	Weaners to 10 weeks of age	$94.70
	Growing pigs 10 to 17 weeks of age	$75.90

This determination is signed by me on the 25th day of January 2012.

Rob Wells
LTS Manager, Technical Standards

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 12/01: INCOME TAX – DEDUCTIBILITY OF EXPENDITURE ON REPLACING AND EXTENDING AN INLET RACE TO A DAIRY SHED

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

This QWBA applies in respect of section DO 4 and Schedule 20.

This item updates and replaces the item "Inlet Race to Milking Shed, Renewed and Extended" published in the *Public Information Bulletin* No 22 (May 1965) p 9. The current relevance of this information was identified during an ongoing review of content published in *Public Information Bulletins* and *Tax Information Bulletins* before 1996. For more information about the review, please see "Review of Public Information Bulletins" in *Tax Information Bulletin* Vol 23, No 1 (February 2011).

Question

1. An inlet race that connects a stock race to a dairy shed complex is inadequate and in very poor condition. The dairy farmer is replacing and extending the old inlet race in concrete. How is the expenditure on replacing and extending the inlet race treated for income tax purposes?

Answer

2. The cost of constructing the new inlet race is a capital expense that can be amortised on a diminished value basis at 6% under section DO 4 and Schedule 20, Part A, Item 4 as "construction of access roads or tracks to or on the land".
3. The inlet race to the dairy shed yard is a separate item to the dairy shed complex itself. It is physically separate. In addition, it performs a separate function in that the race is a form of road or path used for the herd to walk to and from the dairy shed complex, ending at the entrance to the dairy shed holding yard. The dairy shed complex itself, including the yard, is the actual setting for milking. For further information on this point please see Interpretation Statement IS0025 "Dairy farming – Deductibility of certain expenditure" published in *Tax Information Bulletin* Vol 12, No 2 (February 2000) p 10.
4. There is no question that this is, in the circumstances, capital expenditure and not repairs and maintenance.

Explanation

5. A stock race is the track or path along which the cows walk from the paddocks to the dairy shed (and vice versa), ending at the entrance to the dairy shed holding yard. This race may run for some considerable distance through the farm and along farm road frontages. It is designed to confine the herd during its daily treks to and from the dairy shed, and prevent undue damage to pastures. A stock race may be constructed of a variety of materials such as shingle, or compacted limestone or pumice rock. Sometimes a stock race will end in an inlet race, which connects the stock race to the dairy shed complex. An inlet race generally requires a more hard-wearing surface because of frequent and intensive use. Sometimes an inlet race may have a concrete surface. For further discussion about stock races see IS0025 (pp 18–19).
6. Several provisions are relevant in determining whether farm expenditure is deductible. If the expenditure is revenue in nature it is deductible under the general permission (section DA 1). Expenditure that is capital in nature cannot be deducted under the general permission because of the capital limitation (section DA 2(1)). Various factors are relevant in determining whether expenditure is capital in nature: *BP Australia Ltd v FCT* [1965] 3 All ER 209; *CIR v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 14 NZTC 9,101 (CA); *Christchurch Press Company Ltd v CIR* (1993) 15 NZTC 10,206; *CIR v Wattie* (1998) 18 NZTC 13,991 (PC); and *CIR v Birkdale Service Station Ltd & Ors* (2000) 19 NZTC 15,981 (CA). It is considered in general:
   - The cost of work done to an asset to make good ordinary wear and tear and restore it to its former condition will usually be deductible.
   - Where the work done replaces or renews the whole, or substantially the whole, asset or changes the character of the asset the cost of that work will be capital expenditure.

   Therefore, if a taxpayer incurs expenditure on maintaining or repairing an inlet race the expenditure will be deductible under section DA 1.

7. In this situation, however, the farmer incurs expenditure on replacing and extending the inlet race in concrete. This expenditure is capital in nature and is not deductible under the general permission. Under section DO 4 ("Improvements to farmland") a person carrying on a farming or agricultural business on land in New Zealand is allowed a deduction for certain types of expenditure listed in Part A of Schedule 20. Such expenditure will be deductible where it meets the requirements of section DO 4. In particular, such expenditure will be deductible when it is incurred in developing land and is of benefit to the business in the income year in which the person is allowed the deduction. Section DO 4 overrides the capital limitation: section DO 4(7).

8. Section DO 4 allows a certain percentage of the expenditure to be deducted on a diminished value basis. The particular percentage for the item of expenditure is specified in Schedule 20, Part A. Schedule 20, Part A ("Farming") lists at item 4 the "construction of access roads or tracks to or on the land". The percentage of diminished value of improvement allowed as a deduction for the construction of access roads or tracks to or on the land is 6%. Section DO 4 therefore does not allow a full deduction of the cost of constructing access roads or tracks to or on the land in the year in which it is incurred, but as specified in Schedule 20, Part A, item 4, a deduction of 6% of the diminished value is available in each year.

9. This treatment of the expenditure on replacing and extending the inlet race can be contrasted with the treatment that applied at the time the original PIB item was published. At that time, section 119D of the Land and Income Tax Act 1954 permitted a deduction for expenditure on the construction of access roads or tracks to or on the land in the year incurred. This section has been superseded by several legislative amendments. As explained above, under current legislation, a deduction is now allowed for expenditure incurred in relation to construction of access roads and tracks on farms on an amortised basis.

References

Related rulings/ statements	*Public Information Bulletin* No 22 (May 1965) p 9 IS0025 "Dairy farming – Deductibility of certain expenditure" *Tax Information Bulletin* Vol 12, No 2 (February 2000)
Subject references	Dairy farming, deductibility, income tax, inlet race
Legislative references	Income Tax Act 2007, ss DA 1, DA 2, DO 4, Sch 20
Other references	*Tax Information Bulletin* Vol 23, No 1 (February 2011)

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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