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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
QWB0040	Income tax – whether residual land is part of an undertaking or scheme of development or division of land	This draft question we've been asked considers the scenario where a block of land is purchased and subdivided for sale, but some of the land is retained for the owner's own purposes. The issue is whether the amount derived on the eventual sale of that retained lot will be income.	
ED 0147	Questions we've been asked – Do the historic depreciation rates continue to apply to grandparented structures acquired before 1 April 2005?	This draft QWBA clarifies that the historic depreciation rates continue to apply to grandparented structures acquired before 1 April 2005. The draft QWBA also sets out the different rates that apply to grandparented structures in relation to the various acquisition periods.	1 June 2012

Correction – to TIB Vol 24, No 3 (April 2012)

In the item "2012 International tax disclosure exemption ITR23", on page 10, the year of application was incorrectly given as 2011. The ITR23 applies to the income year corresponding to the tax year ended 31 March 2012.

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BINDING RULINGS

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

For full details of how binding rulings work, see *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**

BR PUB 12/01 – 12/03: DEDUCTIBILITY OF BREAK FEES PAID BY A LANDLORD TO EXIT EARLY FROM, OR VARY THE INTEREST RATE OF, A FIXED INTEREST RATE LOAN, OR TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN ON SALE OF A RENTAL PROPERTY

These three public rulings are re-issues of previous rulings which are expiring, and consider the deductibility of mortgage break fees paid by a landlord to exit early from a fixed interest rate loan (including when the property is sold) or vary the interest rate. The rulings are consistent with the conclusions reached previously, and are being issued with a single commentary covering all three.

PUBLIC RULING BR PUB 12/01: DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN

This is a reissue of BR Pub 09/09. For more information about the background to this Public Ruling see the Commentary to this Ruling.

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

Taxation Laws

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

This Ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person subsequently pays a break fee to the lender to repay in full and terminate that loan earlier than its agreed repayment date. It does not matter whether the loan is replaced by further borrowing from either the same or a different lender.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or section EW 15G.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- A base price adjustment will be required.
- The amount of any break fee will be included in the "consideration" element of the base price adjustment formula for a borrower and will increase the overall negative figure that the base price adjustment provides.
- The negative amount under the base price adjustment will be expenditure incurred under the financial arrangements rules and will be interest.
- A company (other than a qualifying company or a look through company) is entitled to a deduction for the negative base price adjustment amount as interest under section DB 7.
- Other taxpayers, including qualifying companies and look through companies, are entitled to a deduction under section DB 6 and the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012–13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

PUBLIC RULING BR PUB 12/02: DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO VARY THE INTEREST RATE OF AN EXISTING FIXED INTEREST RATE LOAN

This is a reissue of BR Pub 09/10. For more information about the background to this Public Ruling see the Commentary to this Ruling.

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

Taxation Laws

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

This ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person then subsequently pays a break fee to the lender for a variation of that loan to adjust the interest rate.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or section EW 15G.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- No base price adjustment will be required.
- Taxpayers who are not cash basis persons, and cash basis persons who have chosen to adopt a spreading method, will be required to apply Determination G25 in relation to the variation to the terms of the loan. The amount of the break fee will be included in the calculation under the determination. This means an adjustment will be made in the year of variation and the deduction of the break fee will effectively be spread over the term of the loan.
- Cash basis persons will be able to deduct the amount of the break fee when it is incurred under the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012–13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

PUBLIC RULING BR PUB 12/03: DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN ON SALE OF RENTAL PROPERTY

This is a reissue of BR Pub 10/20. For more information about the background to this Public Ruling see the Commentary to this Ruling.

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

Taxation Laws

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

This Ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person subsequently pays a break fee to the lender to repay in full and terminate that loan earlier than its agreed repayment date in order to sell the rental property. Therefore, the person ceases to derive rental income from the property.

This Ruling will not apply when the loan is not used solely for the deriving of rental income or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or EW 15G.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- A base price adjustment is required in the income year the loan is repaid.
- The amount of any break fee is included in the "consideration" element of the base price adjustment

formula and will increase the overall negative figure that the base price adjustment provides.

- The negative amount under the base price adjustment is expenditure incurred under the financial arrangements rules and constitutes interest.
- A company (other than a qualifying company or a look through company) is entitled to a deduction for the negative base price adjustment amount as interest under section DB 7.
- Other taxpayers, including qualifying companies and look through companies, are entitled to a deduction under section DB 6 and the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012–13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 12/01, BR PUB 12/02 AND BR PUB 12/03

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 12/01, Public Ruling BR Pub 12/02 and Public Ruling BR Pub 12/03 ("the Rulings").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Background

1. The Rulings deal with the deductibility of fees charged by banks to permit landlords to repay a fixed interest rate loan early or to vary the existing terms of such a loan. These fees are variously referred to by terms such as "early repayment fees", "early repayment adjustment charge", "early exit fees" or "mortgage break fees". In these Rulings, the term "break fee" is used to refer to all such charges.
2. The amount of the fee and the circumstances that trigger the charging of the fee vary from lender to lender. The fee is generally seen as compensation for the loss the lender may have suffered if their current interest rate for a similar loan for a fixed interest rate period closest to the borrower's unexpired fixed interest period is lower than the fixed interest rate applying to the borrower's loan.
3. A break fee is charged in two primary scenarios:
   - the loan is repaid early (whether replaced by further borrowing from the same or another financial institution or not);
   - the interest rate of the loan is simply renegotiated during the term of the loan and the existing loan continues.
4. It may be that the loan is repaid early because the rental property is sold and the landlord ceases to derive assessable income from the property.
5. BR Pub 12/01, BR Pub 12/02 and BR Pub 12/03 are re-issues of BR Pub 09/09, BR Pub 09/10 and BR Pub 10/20 respectively, which expired on the last day of the 2011 – 12 income year. The Rulings are consistent with the conclusions reached in BR Pub 09/09, BR Pub 09/10 and BR Pub 10/20. The Rulings and the commentary required minor adjustments for consistency of wording and were also updated due to legislative amendments. Those amendments do not affect the conclusions.

Application of the Legislation

6. The application of the legislation depends on whether the loan is repaid in full and terminated, or the loan remains in existence and there is simply a variation of the interest rate.

Loan repaid in full

7. A fixed interest rate loan is a financial arrangement pursuant to section EW 3. The financial arrangements rules ("FA rules") will therefore apply. When a loan is repaid in full, a base price adjustment ("BPA") is required under section EW 29.
8. Although many landlords are likely to be cash basis persons under the FA rules and not required to use a spreading method, they are still subject to the FA rules and will be required to do a BPA if the loan is repaid in full.
9. The formula for calculating a BPA is in section EW 31(5). The formula for a borrower is:

   consideration – income + expenditure + amount remitted

10. A break fee charged by a bank in respect of the early repayment of the loan will fall within the definition of "consideration" in section EW 31(7) as "consideration that has been paid ... by the person for or under the financial arrangement". The break fee will not be ignored as a "non-contingent fee" because the fee is not "for services provided for the taxpayer **becoming a party** to the financial arrangement and payable whether or not the financial arrangement proceeds". The fee is payable to allow the taxpayer to cease being a party to the financial arrangement. As the scope of these rulings excludes landlords who have adopted

the International Financial Reporting Standard ("IFRS") financial reporting method under section EW 15D or section EW 15G, it is unnecessary to consider whether the break fee constitutes a non-integral fee.

11. As part of the consideration paid by a borrower, the amount of the break fee will increase the overall negative figure that the BPA provides in this scenario (see Example 1 below).

12. A negative BPA is expenditure incurred under the FA rules pursuant to section EW 31(4) and, in accordance with that section, is deductible pursuant to section DB 6 or DB 7.

13. Negative BPA expenditure is "interest" for the purposes of sections DB 6 and DB 7 (see the definition of "interest" in section YA 1). A non-corporate taxpayer or qualifying company or look-through company will be able to deduct the amount of the negative BPA as interest under section DB 6, provided the general permission in section DA 1 is satisfied and none of the general limitations (excluding the capital limitation) apply. Section DB 6 specifically provides that the capital limitation will not apply, so it is unnecessary to consider whether the amount is of a capital or revenue nature.

14. Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied and the amount of the negative BPA will be deductible under section DB 6.

15. In the case of a company (other than a qualifying company), the amount of the negative BPA will be deductible under section DB 7 without any requirement to consider the general permission. It is noted that a "company" as defined in section YA 1 does not include a look-through company for these purposes.

16. The Commissioner notes that some commentators have suggested section DB 5 may have application when the loan amount is refinanced. Section DB 5 provides a deduction for expenditure incurred in borrowing money used as capital in deriving income. The Commissioner's view is that section DB 5 has no application where the FA rules apply. The amount of the break fee is dealt with under the BPA on repayment of the original loan, as set out above. This will be the case whether or not the amount of the loan is refinanced.

Interest rate varied

17. Instead of repaying a loan in full and then refinancing with a new loan, a borrower may negotiate with their lender to vary the rate of interest on an existing loan. This is sometimes referred to as an "interest rate switch". A break fee will often be charged in these circumstances.

18. Where the renegotiation of the interest rate is simply a variation of the loan and that same loan continues in existence, a BPA is not required. In these circumstances, the deductibility of the break fee depends on whether or not the taxpayer is a cash basis person. Note that if the change in the interest rate is effected by way of the existing loan being discharged and a new loan agreement being entered into, a BPA will be required as discussed above.

19. A taxpayer who is not a cash basis person will have been required to adopt a spreading method in relation to the loan under the FA rules. As the loan is a fixed interest rate loan at the time of the variation, it will not be a variable rate financial arrangement (as defined in Determination G25: Variations in the terms of a financial arrangement). Therefore, the taxpayer will need to apply Determination G25 when the loan is varied, rather than Determination G26: Variable rate financial arrangements. The break fee will be brought into the Determination G25 calculation. This means an adjustment is made in the year of variation and the deduction of the break fee is effectively spread over the term of the loan (see Example 2 below).

20. A cash basis person is not required to adopt a spreading method, although they may choose to do so. A person will be a cash basis person if:

    - the income and expenditure under all the person's financial arrangements for the income year does not exceed $100,000, or
    - the value of all the person's financial arrangements on every day of the income year does not exceed $1 million.

21. In addition, the difference between the accrual treatment and the cash treatment of all the person's financial arrangements cannot exceed $40,000 for the income year. Where a significant break fee is paid, it is possible that these thresholds may be breached and a person may cease to be a cash basis person. In those circumstances the treatment of the break fee set out above for a non-cash basis person will apply.

22. Note that as a result of the changes made by the Taxation (Business Tax Measures) Act 2009 with effect from the 2009/10 income year a non-natural person may be a cash basis person.

23. Where a cash basis person does not adopt a spreading method, the deductibility of the break fee is determined outside the FA rules.

24. The break fee will be incurred whether it is actually paid or simply added to the balance of the loan: *King v CIR* (1973) 1 NZTC 61,107.

25. The break fee will be deductible if it satisfies the general permission and none of the general limitations apply. Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied. Note that if the borrowing was used for a private or domestic purpose, a deduction would be denied under the private limitation in section DA 2(2).

26. Note that section DB 5 will also have no application in these circumstances. Where all that occurs is a variation of the interest rate applicable to a loan, the break fee cannot be said to have been incurred in borrowing money.

Rental property sold

27. The Commissioner's view is the same analysis applies when the loan is repaid in full and terminated regardless of whether the rental property is sold and the landlord ceases to derive assessable income from the property.

28. The BPA is carried out at the time the rental property is sold and the deriving of rental income ceases. The negative BPA amount is deductible as interest as it has a sufficient relationship with the derivation of rental income.

Alternative view – general permission not satisfied

29. The Commissioner notes that some commentators have suggested that because the break fee is paid to allow the taxpayer to dispose of the property, and therefore to cease deriving assessable rental income, the break fee does not have a sufficient relationship with the derivation of assessable income and the general permission is not satisfied to the extent of the amount of the break fee. The Commissioner's view is that the break fee amount is an indivisible part of the negative BPA amount produced by the application of the BPA formula. The BPA provides a net figure at the end of the financial arrangement. This net figure is treated as interest, and it is the deductibility of that interest net figure that must be considered. The individual amounts that go into the BPA formula are not considered separately to determine assessability or deductibility.

Relevance of post-cessation business cases

30. It has also been suggested that relevant here is the line of reasoning in the post-cessation of business cases, such as *Amalgamated Zinc (de Bavay's) Ltd v FCT* (1935) 54 CLR 295, *Case U29* (2000) 19 NZTC 9,273 and *Inglis v CIR* (2001) 20 NZTC 17,379.

31. The post-cessation cases look at the deductibility of expenditure incurred after a business has ceased. These cases are concerned with how long after a business has ceased that expenditure may be claimed. However, under the present arrangement, the BPA is being performed at the same time as the rental property is sold and the deriving of rental income from it ceases. Therefore, the post-cessation cases are not relevant.

Examples

32. The following examples are included to assist in explaining the application of the law.

Example 1 – Loan repaid in full

33. At the beginning of year 1, B borrows $200,000 at a flat 10% per annum fixed interest rate to purchase a rental property from which rental income is derived. The loan is interest only. At the end of year 2, B breaks the loan in order to refinance at a lower interest rate with another bank. B repays the loan and pays an additional $10,000 break fee.

34. B will have to calculate a BPA in relation to the loan as follows:

    consideration – income + expenditure + amount remitted

35. The consideration received by B is the original loan amount of $200,000. The consideration paid by B is the return of the principal, two instalments of interest at $20,000 each, and the break fee of $10,000, or $250,000:

    $200,000 + $20,000 + $20,000 + $10,000

36. There is no income amount or amount remitted. The expenditure amount is the $20,000 interest incurred under the loan in year 1.

37. The BPA is thus:

    ($200,000 – $250,000) – $0 + $20,000 + $0

    = –$50,000 + $20,000

    = –$30,000

38. The negative BPA amount of $30,000 represents the $20,000 interest expense for year 2 and the amount of the break fee.

39. The negative BPA amount is expenditure incurred under the FA rules and is deemed to be interest. It will be deductible to B in the year in which it is incurred under section DB 7 (if B is a company) or section DB 6 and the general permission (if B is a non-corporate or qualifying company).

Example 2 – Interest rate varied

40. A and B are the shareholders in S Ltd. S Ltd owns two residential rental properties. S Ltd borrows $100,000 for three years. Interest is fixed at 10% payable annually in arrears. S Ltd is not a cash basis person. Assuming a straight-line spreading method, the total annual expenditure incurred under the FA rules would be:

    ($100,000 + $30,000 – $100,000) ÷ 3

    = $30,000 ÷ 3

    = $10,000 per annum

41. In year 2 the loan is renegotiated to an 8% interest rate. A break fee of $2,500 is charged. The revised annual finance charges are:

    ($100,000 + $26,000 + $2,500 – $100,000) ÷ 3

    = $28,500 ÷ 3

    = $9,500 pa

42. Determination G25 will apply. The formula is:

    $a - b - c + d$

    where

    - *a* is the sum of all amounts that would have been income derived by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;
    - *b* is the sum of all amounts that would have been expenditure incurred by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;
    - *c* is the sum of all amounts treated as income derived of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year; and
    - *d* is the sum of all amounts treated as expenditure incurred of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year.

43. Applying the Determination G25 formula, the adjustment in year 2 is:

    $0 – $19,000 – $0 + $10,000 = –$9,000

44. This gives total expenditure for years 1 and 2 of $19,000 ($10,000 + $9,000), the equivalent position by the end of year 2 had the revised annual expenditure of $9,500 been claimed from the outset of the financial arrangement. This means the deduction for the break fee is effectively spread over the term of the loan.

Example 3 – Rental property sold

45. At the beginning of year 1, B borrows $200,000 at a flat 10% per year fixed interest rate to purchase a rental property from which rental income is derived. The loan is interest only. At the end of year 2, B breaks the loan in order to sell the property. B repays the loan and pays an additional $10,000 break fee.

46. B must calculate a BPA in relation to the loan as follows:

    consideration – **income + expenditure + amount remitted**

47. The consideration received by B is the original loan amount of $200,000. The consideration paid by B is the return of the principal, two instalments of interest at $20,000 each, and the break fee of $10,000:

    ($200,000 + $20,000 + $20,000 + $10,000)

    = $250,000

48. There is no income or amount remitted. The expenditure is the $20,000 interest incurred under the loan in **year 1**.

49. Therefore, the BPA is:

    ($200,000 – $250,000) – $0 + $20,000 + $0

    = –$50,000 + $20,000

    = –$30,000

50. The negative BPA amount of $30,000 effectively represents the $20,000 interest expense for year 2 and the amount of the break fee.

51. The negative BPA amount is expenditure incurred under the FA rules and is deemed to be interest. If B is a company (other than a qualifying company or a look through company), B will obtain a deduction for the $30,000 in the year in which it is incurred under section DB 7. If B is a non-corporate, a qualifying company or a look through company, the $30,000 will be deductible under section DB 6 and the general permission. The general permission is satisfied because the borrowed money was used to purchase the rental property from which assessable income was derived.

References

Expired Ruling(s)
BR Pub 09/09, BR Pub 09/10, BR Pub 10/20
Subject references
Deductibility, mortgage break fees paid by landlords
Legislative references
Income Tax Act 2007, ss DA 1, DB 6, DB 7, EW 31 and the definition of "interest" in section YA 1
Case references
King v CIR (1973) 1 NZTC 61,107 *Amalgamated Zinc (de Bavay's) Ltd v FCT* (1935)54 CLR 295 *Case U29* (2000) 19 NZTC 9,273 *Inglis v CIR* (2001) 20 NZTC 17,379

APPENDIX – LEGISLATION

Section DA 1(1) and (2) provides:

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the **general permission**.

Section DA 2(1) and (2) provides:

DA 2 General limitations

Capital limitation

(1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.

Private limitation

(2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.

Section DB 6(1) and (4) provides:

DB 6 Interest: Not capital expenditure

Deduction

(1) A person is allowed a deduction for interest incurred.

...

Link with subpart DA

(4) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Section DB 7(1), (2) and (8) provides:

DB 7 Interest: Most companies need no nexus with income

Deduction

(1) A company is allowed a deduction for interest incurred.

Exclusion: Qualifying company

(2) Subsection (1) does not apply to a qualifying company.

...

Link with subpart DA

(8) This section supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply.

Section EW 3(2) and (3) provides:

EW 3 What is a financial arrangement?

Money received for money provided

(2) A financial arrangement is an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person—

(a) at a future time; or

(b) on the occurrence or non-occurrence of a future event, whether or not the event occurs because notice is given or not given.

Examples of money received for money provided

(3) Without limiting subsection (2), each of the following is a financial arrangement—

(a) a debt, including a debt that arises by law:

(b) a debt instrument:

(c) the deferral of the payment of some or all of the consideration for an absolute assignment of some or all of a person's rights under another financial arrangement or under an excepted financial arrangement:

(d) the deferral of the payment of some or all of the consideration for a legal defeasance releasing a person from some or all of their obligations under another financial arrangement or under an excepted financial arrangement.

Section EW 29(3) provides:

EW 29 When calculation of base price adjustment required

Maturity

(3) A party to a financial arrangement must calculate a base price adjustment as at the date on which the arrangement matures.

Section EW 31 provides:

EW 31 Base price adjustment formula

Calculation of base price adjustment

(1) A person calculates a base price adjustment using the formula in subsection (5).

When formula applies

(2) The person calculates the base price adjustment for the income year in which section EW 29 applies to them.

Positive base price adjustment

(3) A base price adjustment, if positive, is income, under section CC 3 (Financial arrangements), derived by the person in the income year for which the calculation is made. However, it is not income to the extent to which it arises from expenditure incurred by the person under the financial arrangement in earlier income years and for which a deduction was denied in those income years.

Negative base price adjustment

(4) A base price adjustment, if negative, is expenditure incurred by the person in the income year for which the calculation is made. The person is allowed a deduction for the expenditure under sections DB 6 to DB 8 (which relate to deductions for interest) or, if none of those sections applies, under section DB 11 (Negative base price adjustment).

Formula

(5) The formula is—

consideration – income + expenditure + amount remitted

Definition of items in formula

(6) The items in the formula are defined in subsections (7) to (11).

Consideration

(7) **Consideration** is all consideration that has been paid, and all consideration that is or will be payable, to the person for or under the financial arrangement, ignoring non-contingent fees, minus all consideration that has been paid, and all consideration that is or will be payable, by the person for or under the financial arrangement. For the purposes of this subsection, the following are ignored:

(a) non-contingent fees, if the relevant method is not the IFRS financial reporting method in section EW 15D:

(b) non-integral fees, if the relevant method is the IFRS financial reporting method in section EW 15D.

Consideration in particular cases

(8) If any of sections EW 32 to EW 48, or EZ 52D applies, the consideration referred to in subsection (7) is adjusted under the relevant section.

Income

(9) **Income** is—

(a) income derived by the person under the financial arrangement in earlier income years; and

(b) dividends derived by the person from the release of the obligation to repay the amount lent; and

(c) income derived under section CF 2(2) and (3) (Remission of specified suspensory loans).

Expenditure

(10) **Expenditure** is expenditure incurred by the person under the financial arrangement in earlier income years.

Amount remitted

(11) **Amount remitted** is an amount that is not included in the consideration paid or payable to the person because it has been remitted—

(a) by the person; or

(b) by law.

Section EW 54 provides:

EW 54 Meaning of cash basis person

Who is cash basis person

(1) A person is a ***cash basis person*** for an income year if—

(a) 1 of the following applies in the person's case for the income year:

(i) section EW 57(1); or

(ii) section EW 57(2); and

(b) section EW 57(3) applies in the person's case for the income year.

Persons excluded by Commissioner

(2) A person may be excluded under section EW 59 from being a cash basis person for a class of financial arrangements.

Section EW 55 provides:

EW 55 Effect of being cash basis person

Use of spreading method

(1) A cash basis person is not required to apply any of the spreading methods to any of their financial arrangements, but may choose to do so under section EW 61.

Calculation of base price adjustment

(2) The fact that a cash basis person does not use any of the spreading methods for the financial arrangement does not excuse them from the requirement to calculate a base price adjustment when any of section EW 29(1) to (12) applies to them.

Section EW 57(1)–(9) provides:

EW 57 Thresholds

Income and expenditure threshold

(1) For the purposes of section EW 54(1)(a)(i), this subsection applies if the absolute value of the person's income and expenditure in the income year under all financial arrangements to which the person is a party is $100,000 or less.

Absolute value threshold

(2) For the purposes of section EW 54(1)(a)(ii), this subsection applies if, on every day in the income year, the absolute value of all financial arrangements to which the person is a party added together is $1,000,000 or less. The value of each arrangement is,—

(a) for a fixed principal financial arrangement, its face value:

(b) for a variable principal debt instrument, the amount owing by or to the person under the financial arrangement:

(c) for a financial arrangement to which the old financial arrangements rules apply, the value determined under those rules.

Deferral threshold

(3) For the purposes of section EW 54(1)(b), this subsection applies if the result of applying the formula in subsection (4) to each financial arrangement to which the person is a party at the end of the income year and adding the outcomes together is $40,000 or less.

Formula

(4) The formula is—

(accrual income – cash basis income) + (cash basis expenditure – accrual expenditure)

Definition of items in formula

(5) The items in the formula are defined in subsections (6) to (9).

Accrual income

(6) **Accrual income** is the amount that would have been income derived by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Cash basis income

(7) **Cash basis income** is the amount that would have been income derived by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Cash basis expenditure

(8) **Cash basis expenditure** is the amount that would have been expenditure incurred by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Accrual expenditure

(9) **Accrual expenditure** is the amount that would have been expenditure incurred under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Increase in specified sums

(10) The Governor-General may make an Order in Council increasing a sum specified in any of subsections (1) to (3).

In section YA 1, the definitions of "company", "IFRS", "interest", "maturity", "non-contingent fee", and "non-integral fee" provide as follows:

YA 1 Definitions

Company,—

(a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:

(ab) does not include a partnership:

(abb) does not include a look-through company, except in the PAYE rules, the FBT rules, the NRWT rules, the RWT rules, the ESCT rules, the RSCT rules, and for the purposes of subpart FO (Amalgamation of companies):

(ac) includes a listed limited partnership:

(ad) includes a foreign corporate limited partnership:

(b) includes a unit trust:

(c) includes a group investment fund that is not a designated group investment fund, but only to the extent to which the fund results from investments made into it that are—

(i) not from a designated source, as defined in section HR 3(5) (Definitions for section HR 2: group investment funds); and

(ii) not made before 23 June 1983, including an amount treated as invested at that date under the definition of **pre-1983 investment** in section HR 3(8):

(d) includes an airport operator:

(e) includes a statutory producer board:

(f) includes a society registered under the Incorporated Societies Act 1908:

(g) includes a society registered under the Industrial and Provident Societies Act 1908:

(h) includes a friendly society:

(i) includes a building society:

(j) is further defined in section EX 30(7) (Direct income interests in FIFs) for the purposes of that section

IFRS,—

means a New Zealand Equivalent to International Financial Reporting Standard, approved or issued under the Financial Reporting Act 1993, and as amended from time to time or an equivalent standard issued in its place

interest,—

...

(c) in sections DB 6 (Interest: not capital expenditure), DB 7 (Interest: most companies need no nexus with income), and DB 8 (Interest: money borrowed to acquire shares in group companies),—

(i) includes expenditure incurred under the financial arrangements rules or the old financial arrangements rules

...

maturity,—

(a) in the financial arrangements rules, means,—

(i) for an agreement for the sale and purchase of property or services or an option, the date on which the agreement or option ends:

(ii) for any other financial arrangement, the date on which the last payment contingent on the financial arrangement is made:

...

non-contingent fee means a fee that—

(a) is for services provided for a person becoming a party to a financial arrangement; and

(b) is payable whether or not the financial arrangement proceeds

non-integral fee means a fee or transaction cost that, for the purposes of financial reporting under IFRSs, is not an integral part of the effective interest rate of a financial arrangement

In Determination G25: Variations in the Terms of a Financial Arrangement, the definition of "Variable Rate Financial Arrangement" reads as follows:

Variable Rate Financial Arrangement means a financial arrangement under which:

(a) the interest rate is determined by a fixed relationship to economic, commodity, industrial or financial indices or prices, or banking or general commercial rates; or

(b) the interest rate is set periodically by reference to market interest rates.

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

ORDER IN COUNCIL

USE-OF-MONEY INTEREST RATES CHANGE

The use-of-money interest rates on underpayments and overpayments of taxes and duties have changed, in line with market interest rates. The new rates are:

- underpayment rate: 8.40% (currently 8.89%)
- overpayment rate: 1.75% (currently 2.18%).

The new rates apply from 8 May 2012, the day after the third instalment of provisional tax is paid by taxpayers with a standard balance date.

Rates are reviewed regularly to ensure they are in line with market interest rates. The new rates are consistent with the Reserve Bank floating first mortgage new customer housing rate and the 90-day bank bill rate.

The rates were changed by Order in Council on 26 March 2012.

Taxation (Use of Money Interest Rates) Amendment Regulations 2012 (2012/59)

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.

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the 12 months ending 31 March 2012.

The Income Tax Act 2007 ("2007 Act") requires foreign currency amounts to be converted into New Zealand dollars applying one of the following methods:

- actual rate for the day for each transaction (including close of trading spot exchange rate on the day), or
- rolling 12-month average rate for a 12-month accounting period or income year (see the table **Currency rates 12 months ending 31 March 2012 – rolling 12-month average**), or
- mid-month actual rate as the basis of the rolling average for accounting periods or income years greater or lesser than 12 months (see the table **Currency rates 12 months ending 31 March 2012 – mid-month actual**).

Legislation enacted in September 2010 with effect from 1 April 2008 permits the Commissioner to set currency rates and approve methods of calculating exchange rates. The Commissioner can set rates for general use by taxpayers or for specific taxpayers. The Commissioner's ability to set rates and approve methods applies in all circumstances, ie, where the Act does not contain a specific currency conversion rule (sections YF 1(5) and (6)), or in circumstances where the Act provides a rate or method for currency conversion (section YF 2).

Inland Revenue uses wholesale rates from Bloomberg for rolling 12-month average, mid-month actual and end of month. These rates are provided in three tables.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note: All section references relate to the Income Tax Act 2007.

Actual rate for the day for each transaction

The actual rate for the day for each transaction can be used in the following circumstances:

- Where the 2007 Act does not provide a specific currency conversion rule, then foreign currency amounts can be converted by applying the close of trading spot exchange rate on the date that the transaction which is required to be measured or calculated occurs (section YF 1(2)).
- Where a person chooses to use the actual rate for the day of the transaction when calculating their FIF income or loss when applying either: the comparative value method, fair dividend rate method, deemed rate of return method or the cost method (section EX 57(2)(a)).
- Where a person chooses to use the close of trading spot exchange rate to convert foreign income tax paid by a CFC (section LK 3(a)).

Unless the actual rate is the 15th or the last day of the month, these rates are not supplied by Inland Revenue.

The table **Currency rates 12 months ending 31 March 2012 – month end** provides exchange rates for the last day of the month. These are provided for convenience to assist taxpayers who may need exchange rates on those days.

Currency rates 12 months ending 31 March 2012 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average. This table should be used where the accounting period or income year encompasses 12 complete months.

This table can be used to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the accounting profits method (section EX 49(8)); comparative value

method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b))

- branch equivalent income or loss calculated under the CFC and FIF rules (section EX 21(4)) for accounting periods of 12 months
- foreign tax credits calculated under the branch equivalent method for a CFC or FIF under section LK 3(b) for accounting periods of 12 months.

Currency rates 12 months ending 31 March 2012 – mid-month actual table

This table sets out the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted. This table can be used as the basis of the rolling average where the accounting period or income year is less than or greater than 12 months (see Example 4). You can also use the rates from this table as the actual rate for any transactions arising on the 15th of the month.

This table can be used as the basis of the rolling average for calculating:

- branch equivalent income or loss calculated under the CFC or FIF rules (section EX 21(4)) for accounting periods of less than or greater than 12 months
- a person's FIF income or loss under: the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods or income years of less than or greater than 12 months
- foreign tax credits calculated under the branch equivalent method for a CFC or FIF under section LK 3(b) for accounting periods of less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippine company (which is a FIF but does produce a guaranteed yield) on 7 September 2011. Its opening market value on 1 October 2011 or its closing market value on 30 September 2011 is PHP 350,000. Using the comparative value method and applying the actual rate for the day (section EX 57(2)(a)), the opening market value is converted as follows:

PHP 350,000 ÷ 33.5621 = $10,428.43

(In this example, the rate selected is the month-end rate for September 2011 for PHP. Refer to the table "Currency rates 12 months ending 31 March 2012 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 31 December 2011. Branch equivalent income for the period 1 January 2011 to 31 December 2011 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 6.1470 = $32,536.19

(In this example, the rate selected is the rolling 12-month average rate for December 2011 for HKD. Refer to the table "Currency rates 12 months ending March 2012 – rolling 12-month average".)

Example 3

A resident individual with a 31 October 2011 accounting period acquires a FIF interest in a Japanese company on 1 November 2010 for 10,500,000 yen. The interest is sold in October 2011 for 10,000,000 yen. Using the comparative value method and applying section EX 57(2)(b), these amounts are converted as:

JPY 10,500,000 ÷ 63.6430 = $164,982.79

JPY 10,000,000 ÷ 63.6430 = $157,126.47

(In this example, the rolling 12-month rate for October 2011 has been applied to both calculations. Refer to the table "Currency rates 12 months ending March 2012 – rolling 12-month average".)

Example 4

A CFC resident in Singapore was formed on 21 April 2011 and has a balance date of 30 September 2011. During the period 1 May 2011 to 30 September 2011, branch equivalent income of 500,000 Singaporean dollars was derived. For the conversion to New Zealand dollars the taxpayer chooses the method set out in section EX 21(4)(b).

1. Calculating the average monthly exchange rate for the complete months May-September 2011:

   0.9805 + 0.9986 + 1.0310 + 1.0004 + 1.0228 = 5.0333

   5.0333 ÷ 5 = 1.0067
2. Round exchange rate to four decimal places: 1.0067
3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 1.0067 = $496,672.30

(In this example, the rates are from the table "Currency rates 12 months ending March 2012 – mid-month actual", from May to September 2011 inclusive for SGD.)

Currency rates 12 months ending 31 March 2012 – rolling 12-month average

Currency	Code	15/04/11	15/05/11	15/06/11	15/07/11	15/08/11	15/09/11	15/10/11	15/11/11	15/12/11	15/01/12	15/02/12	15/03/12
Australia Dollar	AUD	0.7769	0.7724	0.7687	0.7661	0.7662	0.7678	0.7690	0.7668	0.7676	0.7672	0.7692	0.7725
Bahrain Dinar	BHD	0.2793	0.2818	0.2852	0.2888	0.2928	0.2957	0.2973	0.2972	0.2976	0.2985	0.3011	0.3039
Britain Pound	GBH	0.4729	0.4729	0.4751	0.4794	0.4840	0.4884	0.4915	0.4920	0.4928	0.4958	0.5012	0.5067
Canada Dollar	CAD	0.7476	0.7502	0.7563	0.7603	0.7670	0.7720	0.7761	0.7767	0.7797	0.7842	0.7916	0.7992
China Yuan	CNY	4.9500	4.9742	5.0125	5.0550	5.0983	5.1258	5.1358	5.1167	5.1058	5.1033	5.1275	5.1592
Denmark Kroner	DKK	4.1560	4.1478	4.1502	4.1717	4.1860	4.2058	4.2296	4.2297	4.2406	4.2737	4.3222	4.3852
Euporean Community Euro	EUR	0.5578	0.5566	0.5568	0.5596	0.5615	0.5642	0.5674	0.5675	0.5691	0.5737	0.5804	0.5890
Fiji Dollar	FJD	1.3894	1.3905	1.3937	1.3984	1.4054	1.4112	1.4159	1.4152	1.4161	1.4174	1.4237	1.4334
French Polynesia Franc	XPF	66.5133	66.3881	66.4224	66.7543	66.9893	67.3013	67.6954	67.7052	67.9213	68.4618	69.2641	70.2855
Hong Kong Dollar	HKD	5.7611	5.8123	5.8822	5.9590	6.0424	6.1037	6.1368	6.1379	6.1470	6.1650	6.2149	6.2692
India Rupee	INR	33.7384	34.0177	34.3141	34.6139	35.0103	35.4483	35.9596	36.2929	36.8395	37.3570	37.9543	38.6220
Indonesia Rupiah	IDR	6,641.6300	6,665.1075	6,707.7767	6,759.6625	6,824.2883	6,881.1800	6,910.4258	6,910.1733	6,925.4992	6,953.7700	7,022.5083	7,109.6808
Japan Yen	JPY	63.0609	62.9128	63.0283	63.2921	63.5550	63.5932	63.6430	63.2438	62.9394	62.7459	62.9420	63.7239
Korea Won	KOR	851.0079	854.8993	856.3455	858.1016	863.0223	868.7627	876.1993	875.4277	876.4410	881.5169	889.0823	896.5528
Kuwait Dinar	KWD	0.2101	0.2111	0.2127	0.2145	0.2164	0.2178	0.2185	0.2182	0.2183	0.2188	0.2206	0.2227
Malaysia Ringit	MYR	2.3132	2.3221	2.3354	2.3528	2.3733	2.3955	2.4113	2.4117	2.4186	2.4305	2.4520	2.4725
Norway Krone	NOK	4.4093	4.4069	4.4093	4.4264	4.4381	4.4491	4.4572	4.4413	4.4496	4.4779	4.5145	4.5640
Pakistan Rupee	PKR	63.2442	63.8767	64.6738	65.5041	66.4488	67.2463	67.6626	67.7367	68.0930	68.6416	69.6129	70.6234
Phillipines Peso	PHP	32.8874	33.0628	33.2984	33.5051	33.7840	34.0628	34.2413	34.2206	34.2787	34.3431	34.5877	34.8348
PNG Kina	PGK	1.9738	1.9670	1.9573	1.9477	1.9434	1.9322	1.9140	1.8835	1.8554	1.8257	1.8069	1.7917
Singapore Dollar	SGD	0.9783	0.9782	0.9804	0.9828	0.9860	0.9897	0.9930	0.9921	0.9930	0.9964	1.0039	1.0119
Solomon Islands Dollar*	SBD	5.7976	5.8339	5.8603	5.9037	5.9600	5.9876	5.9909	5.9681	5.9401	5.9199	5.9255	5.9381
South Africa Rand	ZAR	5.2937	5.3095	5.3268	5.3528	5.4136	5.4884	5.5828	5.6578	5.7633	5.8590	5.9376	6.0335
Sri Lanka Rupee	LKR	82.8439	83.3074	84.0683	84.8973	85.8593	86.6044	86.9169	86.7951	87.0870	87.5324	88.8388	90.6218
Sweden Krona	SEK	5.1357	5.0991	5.0827	5.0984	5.1049	5.1247	5.1500	5.1397	5.1557	5.1936	5.2542	5.3273

Currency	Code	15/04/11	15/05/11	15/06/11	15/07/11	15/08/11	15/09/11	15/10/11	15/11/11	15/12/11	15/01/12	15/02/12	15/03/12
Swiss Franc	CHF	0.7400	0.7317	0.7231	0.7172	0.7098	0.7084	0.7078	0.7032	0.7025	0.7041	0.7076	0.7147
Taiwan Dollar	TAI	22.6720	22.6867	22.7481	22.8287	22.9386	23.0373	23.1386	23.1332	23.1999	23.3325	23.5366	23.7496
Thailand Baht	THB	22.8969	22.9760	23.1415	23.2991	23.4945	23.6975	23.8817	23.9439	24.0623	24.2237	24.4387	24.6826
Tonga Pa'anga*	TOP	1.3834	1.3828	1.3848	1.3837	1.3799	1.3764	1.3727	1.3650	1.3596	1.3556	1.3560	1.3589
United States Dollar	USD	0.7410	0.7476	0.7566	0.7662	0.7768	0.7845	0.7886	0.7885	0.7896	0.7920	0.7987	0.8060
Vanuatu Vatu	VUV	72.1856	72.2291	72.3179	72.5553	72.9642	73.2387	73.5092	73.3341	73.4626	73.6455	74.1034	74.7176
West Samoan Tala*	WST	1.7593	1.7617	1.7648	1.7701	1.7796	1.7876	1.7934	1.7916	1.7947	1.7973	1.8052	1.8158

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2012 – mid-month actual

Currency	Code	15/04/11	15/05/11	15/06/11	15/07/11	15/08/11	15/09/11	15/10/11	15/11/11	15/12/11	15/01/12	15/02/12	15/03/12
Australia Dollar	AUD	0.7566	0.7447	0.7627	0.7934	0.7927	0.7977	0.7787	0.7578	0.7593	0.7697	0.7791	0.7781
Bahrain Dinar	BHD	0.3014	0.2968	0.3040	0.3186	0.3140	0.3106	0.3036	0.2908	0.2840	0.2996	0.3143	0.3088
Britain Pound	GBH	0.4897	0.4860	0.4981	0.5237	0.5081	0.5214	0.5091	0.4875	0.4856	0.5188	0.5308	0.5214
Canada Dollar	CAD	0.7669	0.7629	0.7897	0.8062	0.8155	0.8104	0.8132	0.7876	0.7796	0.8133	0.8330	0.8124
China Yuan	CNY	5.2200	5.1200	5.2300	5.4600	5.3200	5.2600	5.1400	4.9000	4.8000	5.0200	5.2500	5.1900
Denmark Kroner	DKK	4.1323	4.1578	4.2438	4.4547	4.2953	4.4217	4.3203	4.2399	4.3018	4.6609	4.7383	4.6560
Euporean Community Euro	EUR	0.5541	0.5577	0.5689	0.5972	0.5766	0.5937	0.5801	0.5697	0.5788	0.6268	0.6379	0.6262
Fiji Dollar	FJD	1.4051	1.3902	1.4247	1.4813	1.4579	1.4590	1.4428	1.4086	1.3872	1.4271	1.4611	1.4552
French Polynesia Franc	XPF	66.1217	66.5970	67.9117	71.2747	68.8180	70.7960	69.2546	68.0214	69.0890	74.8608	76.0447	74.6364
Hong Kong Dollar	HKD	6.2155	6.1199	6.2841	6.5897	6.4874	6.4174	6.2636	6.0035	5.8619	6.1714	6.4580	6.3582
India Rupee	INR	35.4414	35.3224	36.0989	37.6141	37.7635	39.1794	39.4815	38.9508	40.1347	40.9577	41.4023	41.1177
Indonesia Rupiah	IDR	6922.7600	6736.9900	6892.5800	7218.2000	7110.0700	7239.8000	7127.0000	6937.5300	6856.5000	7282.5400	7525.1700	7467.0300
Japan Yen	JPY	66.4650	63.6180	65.3040	66.9150	63.9870	63.1880	62.1920	59.4130	58.6520	61.1710	65.3320	68.4500
Korea Won	KOR	870.5069	857.4841	876.6095	893.8417	898.5968	916.8085	930.7219	870.1990	871.7394	914.9390	936.2442	920.9425
Kuwait Dinar	KWD	0.2210	0.2170	0.2219	0.2317	0.2268	0.2266	0.2219	0.2129	0.2098	0.2223	0.2318	0.2287
Malaysia Ringit	MYR	2.4167	2.3639	2.4462	2.5427	2.4817	2.5458	2.5209	2.4300	2.4009	2.4848	2.5501	2.4861
Norway Krone	NOK	4.2953	4.3831	4.4792	4.6977	4.5265	4.5867	4.4795	4.4339	4.5172	4.8154	4.8173	4.7357
Pakistan Rupee	PKR	67.1141	67.1141	69.4444	72.4638	71.9424	72.4638	69.9301	67.1141	67.5676	71.9424	75.7576	74.6269
Phillipines Peso	PHP	34.5537	33.9624	35.1150	36.2410	35.3230	35.6899	34.8382	33.5308	33.1888	34.7192	35.8480	35.0073
PNG Kina	PGK	2.0125	1.8869	1.8530	1.9160	1.8678	1.8457	1.7652	1.6494	1.6116	1.6770	1.7229	1.6919
Singapore Dollar	SGD	0.9940	0.9805	0.9986	1.0310	1.0004	1.0228	1.0192	0.9964	0.9852	1.0276	1.0526	1.0342
Solomon Islands Dollar*	SBD	6.1474	6.0160	5.8156	6.2735	6.2288	6.1188	5.9839	5.7472	5.4626	5.7705	5.8938	5.7987
South Africa Rand	ZAR	5.4349	5.5276	5.5172	5.8205	5.8881	6.0924	6.3071	6.3031	6.3429	6.4612	6.4592	6.2483
Sri Lanka Rupee	LKR	88.4956	86.2069	88.4956	92.5926	90.9091	90.9091	88.4956	84.7458	85.4701	90.0901	99.0099	102.0408
Sweden Krona	SEK	4.9459	5.0297	5.2243	5.4882	5.3359	5.4228	5.3104	5.1969	5.2562	5.5563	5.6008	5.5604

Currency	Code	15/04/11	15/05/11	15/06/11	15/07/11	15/08/11	15/09/11	15/10/11	15/11/11	15/12/11	15/01/12	15/02/12	15/03/12
Swiss Franc	CHF	0.7134	0.7027	0.6881	0.6885	0.6531	0.7163	0.7180	0.7057	0.7081	0.7571	0.7692	0.7560
Taiwan Dollar	TAI	23.2094	22.5487	23.2998	24.4122	23.8624	24.4444	24.3936	23.3308	22.8484	23.8416	24.6110	24.1929
Thailand Baht	THB	24.0926	23.8397	24.6355	25.4126	24.8613	24.9896	24.7887	23.7681	23.6833	25.2772	25.6637	25.1791
Tonga Pa'anga*	TOP	1.4183	1.3856	1.3739	1.3903	1.3424	1.3487	1.3546	1.3173	1.2888	1.3463	1.3749	1.3663
United States Dollar	USD	0.7995	0.7874	0.8066	0.8454	0.8328	0.8238	0.8053	0.7713	0.7534	0.7947	0.8329	0.8191
Vanuatu Vatu	VUV	74.0741	72.4638	73.5294	76.9231	76.3359	75.7576	75.1880	71.4286	72.4638	75.1880	76.9231	76.3359
West Samoan Tala*	WST	1.8031	1.7698	1.7948	1.8589	1.8548	1.8484	1.8352	1.7707	1.7627	1.8061	1.8451	1.8403

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2012 – month end

Currency	Code	30/04/11	31/05/11	30/06/11	31/07/11	31/08/11	30/09/11	31/10/11	30/11/11	31/12/11	31/01/12	29/02/12	31/03/12
Australia Dollar	AUD	0.7383	0.7720	0.7733	0.7990	0.7981	0.7883	0.7661	0.7593	0.7614	0.7782	0.7772	0.7930
Bahrain Dinar	BHD	0.3053	0.3105	0.3126	0.3316	0.3220	0.2872	0.3042	0.2943	0.2931	0.3118	0.3145	0.3084
Britain Pound	GBH	0.4848	0.5009	0.5165	0.5355	0.5256	0.4887	0.5015	0.4970	0.5002	0.5246	0.5240	0.5113
Canada Dollar	CAD	0.7654	0.7979	0.7988	0.8395	0.8351	0.7999	0.8073	0.7941	0.7942	0.8289	0.8257	0.8172
China Yuan	CNY	5.2600	5.3400	5.3600	5.6600	5.4500	4.8600	5.1300	4.9800	4.9000	5.2100	5.2500	5.1500
Denmark Kroner	DKK	4.0793	4.2655	4.2648	4.5510	4.4281	4.2328	4.3318	4.3162	4.4581	4.6967	4.6541	4.5650
Euporean Community Euro	EUR	0.5470	0.5723	0.5718	0.6102	0.5943	0.5688	0.5822	0.5805	0.6000	0.6317	0.6260	0.6135
Fiji Dollar	FJD	1.4102	1.4418	1.4480	1.5020	1.4780	1.3787	1.4249	1.4643	1.4318	1.4539	1.4565	1.4531
French Polynesia Franc	XPF	65.1384	68.3083	68.1508	73.0418	70.9581	67.8403	69.5698	69.3180	71.5949	75.3549	74.6246	73.2071
Hong Kong Dollar	HKD	6.2902	6.4071	6.4524	6.8539	6.6502	5.9280	6.2667	6.0628	6.0370	6.4119	6.4696	6.3585
India Rupee	INR	35.8147	37.1193	36.9982	38.8647	39.3694	37.2952	39.2777	40.6913	41.2905	40.9574	41.3930	41.8047
Indonesia Rupiah	IDR	6935.1400	7037.1000	7111.5100	7479.6500	7283.2100	6919.6000	7155.3400	7087.2600	7056.0500	7437.4200	7599.1300	7508.1600
Japan Yen	JPY	65.7520	67.1610	66.8030	67.5380	65.4750	58.6660	63.0590	60.5770	59.7830	63.0630	67.6860	68.0050
Korea Won	KOR	865.8048	887.8274	885.9429	926.4817	910.5444	901.5317	899.5000	890.7651	901.9763	929.3164	933.6172	928.8146
Kuwait Dinar	KWD	0.2222	0.2267	0.2276	0.2398	0.2328	0.2109	0.2218	0.2161	0.2166	0.2293	0.2315	0.2275
Malaysia Ringit	MYR	2.3985	2.4820	2.5038	2.6106	2.5382	2.4279	2.4730	2.4805	2.4630	2.5132	2.5219	2.5160
Norway Krone	NOK	4.2514	4.4324	4.4669	4.7281	4.5837	4.4665	4.4799	4.5041	4.6423	4.8477	4.6640	4.6606
Pakistan Rupee	PKR	68.4932	70.9220	71.4286	76.3359	74.6269	66.6667	69.9301	69.4444	69.9301	74.6269	75.7576	74.6269
Phillipines Peso	PHP	34.6682	35.5702	35.9054	37.0443	36.0936	33.5621	34.4658	33.7191	34.0906	35.3665	35.9880	35.2280
PNG Kina	PGK	1.9794	1.9376	1.8920	1.9784	1.9125	1.6985	1.7488	1.6728	1.6610	1.7228	1.7158	1.6855
Singapore Dollar	SGD	0.9916	1.0161	1.0186	1.0588	1.0287	0.9954	1.0121	1.0002	1.0076	1.0404	1.0441	1.0310
Solomon Islands Dollar*	SBD	6.1498	6.3622	6.2153	6.5618	6.3907	5.6577	5.9943	5.6899	5.6314	5.8509	5.9026	5.7958
South Africa Rand	ZAR	5.3201	5.6050	5.6077	5.8811	5.9715	6.1644	6.4215	6.3292	6.2878	6.4580	6.2613	6.2823
Sri Lanka Rupee	LKR	89.2857	90.0901	90.9091	96.1538	93.4579	84.0336	88.4956	88.4956	90.0901	94.3396	102.0408	105.2632
Sweden Krona	SEK	4.8942	5.0839	5.2473	5.5241	5.4185	5.2338	5.2467	5.2792	5.3509	5.6206	5.5228	5.4147

Currency	Code	30/04/11	31/05/11	30/06/11	31/07/11	31/08/11	30/09/11	31/10/11	30/11/11	31/12/11	31/01/12	29/02/12	31/03/12
Swiss Franc	CHF	0.7009	0.7035	0.6969	0.6909	0.6884	0.6915	0.7075	0.7127	0.7285	0.7602	0.7544	0.7414
Taiwan Dollar	TAI	23.2334	23.6012	23.9228	25.3726	24.7842	23.3293	24.1684	23.6931	23.5660	24.4748	24.5510	24.1570
Thailand Baht	THB	24.1998	24.9762	25.4798	26.1672	25.5725	23.7503	24.7747	24.1037	24.5282	25.6120	25.4051	25.2313
Tonga Pa'anga*	TOP	1.4113	1.4115	1.4112	1.3884	1.3692	1.2989	1.3210	1.3322	1.3251	1.3748	1.3725	1.4011
United States Dollar	USD	0.8099	0.8239	0.8292	0.8793	0.8541	0.7614	0.8067	0.7805	0.7772	0.8268	0.8341	0.8187
Vanuatu Vatu	VUV	72.9927	75.1880	75.7576	78.7402	77.5194	72.4638	73.5294	74.6269	74.0741	76.3359	76.3359	76.3359
West Samoan Tala*	WST	1.8022	1.8333	1.8394	1.8975	1.8665	1.7794	1.7895	1.8130	1.7945	1.8451	1.8380	1.8357

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

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 12/03: INCOME TAX – DEDUCTIBILITY OF EXPENDITURE ON CATTLE STOPS

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

This QWBA applies in respect of s DO 1(1)(f).

The item "Expenses Allowable To Farmers Who Convert To Tanker Collection" was published in *Public Information Bulletin* No 20, p 11 (March 1965) ("the old PIB item"). This QWBA updates and replaces the parts of the old PIB item that relate to new cattle stops. 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. The Commissioner's view on the other parts of the old PIB item that are still relevant are set out in the following items: QB 12/04: Income tax – deductibility of expenditure on widening or metalling a farm access road or track; Operational Statement 007: Income tax treatment of certain expenditures on conversion of one farming or agricultural purpose to another; and Interpretation Statement IS0025: Dairy farming – deductibility of certain expenditure. As a result, the old PIB item is no longer current and should not be relied on. 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. A farmer is constructing a new cattle stop as part of a fence where it crosses a farm track. How is the expenditure treated for income tax purposes?

Answer

2. Where a cattle stop is constructed in an opening in a fence, the cost of constructing the cattle stop is deductible in the year in which it is incurred. The deduction is available under s DO 1(1)(f) as expenditure incurred on the construction on the land of fences for farming or agricultural purposes (assuming the expenditure was incurred in carrying on a farming or agricultural business on land in New Zealand).

Explanation

3. Specific farming deductions are available in subpart DO. Section DO 1 ("Enhancements to land, except trees") allows an immediate deduction for the expenditure incurred in constructing fences. Section DO 1 overrides the capital limitation. Section DO 1(1) relevantly provides:

> **DO 1 Enhancements to land, except trees**
>
> *Deduction*
>
> (1) A person is allowed a deduction for expenditure that they incur on the following in carrying on a farming or agricultural business on land in New Zealand:
>
> ...
>
> (f) the construction on the land of fences for farming or agricultural purposes, including buying wire or wire netting for the purpose of making new or existing fences rabbit-proof:

4. Assuming the expenditure was incurred in the carrying on of a farming or agricultural business on land in New Zealand, the ability to deduct the expenditure incurred in constructing the cattle stop under s DO 1(1)(f) depends on whether the cattle stop falls within the meaning of "construction on the land of fences" in that section.

What is a cattle stop?

5. The *New Zealand Oxford Dictionary* (Oxford University Press, Australia, 2005) defines the term "cattle grid" (another term for "cattle stop") as follows:

> **cattle grid** (on a road, in an opening in a fence) a set of metal rails fixed on the ground over a shallow trench and so spaced as to allow vehicles to pass over but not cattle, sheep, etc.

6. This suggests that a cattle stop is an alternative to a gate: it prevents stock from leaving an enclosed area but allows vehicles and people to pass through without the need to open and close a gate. When located in an opening in a fence, both (closed) gates and cattle stops continue the line of barrier provided by a fence.

What is a "fence"?

7. The *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, New York, 2007) relevantly defines "fence" as follows:

> **fence** noun…**3** a railing or barrier constructed of posts of any of various materials connected by wire, planks, etc., used to enclose and prevent entry to and exit from a field, yard, etc.

8. The dictionary definition of "fence" shows that the ordinary meaning of the word "fence" is an upright structure that is comprised of posts (of any of various materials) connected by wire or wood. The definition also shows that the purpose of a fence is to enclose an area to prevent or control access to and from that enclosed area.

9. *Halsbury's Laws of England* (5th ed, 2011) Vol 4, Boundaries, in relation to the rights, duties and liabilities of owners of fences, provides the following definition of fences at [350]:

> Although fences are frequently used to mark the situation of boundaries, none the less they are primarily guards against intrusion, or barriers to prevent persons or animals straying out, and therefore in this sense the term includes not only hedges, banks, and walls, but also ditches. But an external party wall forming part of a building and alongside or on the boundary of land is not usually regarded as a fence.

10. The word "fence" is also defined in other New Zealand Acts. For example, the Fencing Act 1978 provides the following definitions:

> **Fence** means a fence, whether or not continuous or extending along the whole boundary separating the lands of adjoining occupiers; and includes all gates, culverts, and channels that are part of or are incidental to a fence; and also includes any natural or artificial watercourse or live fence, or any ditch or channel or raised ground that serves as a dividing fence.
>
> **Adequate fence** means a fence that, as to its nature, condition, and state of repair, is reasonably satisfactory for the purpose that it serves or is intended to serve

11. While not decided in a tax context, the following cases are useful because they discuss the ordinary meaning of the word "fence".

12. In the New Zealand Environment Court case of *Collins v Wooff* [2010] NZEnvC 227, the court was prepared to contemplate a wider range of fences than typical post and wire fencing when considering what the phrase "standard rural fencing" meant. This was in the context of a resource consent that contained a fencing covenant requiring the defendant to erect only "standard rural fencing" on his property. However, the defendant's case failed because he could not show that the 8 metre stone wall he had erected next to his driveway performed the function of a fence. The court was not persuaded that the fencing covenant necessarily ruled out stone walls because such structures were commonly used as fences on farms in other parts of New Zealand. However, in this case, the wall was not a "fence" because it did not form a barrier or enclose anything. In the court's view (seemingly based on the dictionary definition) the function of a fence is to form a barrier or enclose an area of land.

13. Similarly, in *Kontikis v Schreiner* (1989) 16 NSWLR 706, 68 LGRA 301 the Court of Appeal of the Supreme Court of New South Wales considered that for a structure to be a fence, the structure must not merely bound land in fact but must be there functionally or essentially for that purpose. In addition, the court considered that a "fence" may have overlapping purposes or perform other functions.

14. In *Lahey v Hartford Fire Insurance Co* [1968] OR 727 at [6], the Ontario High Court of Justice considered that "fence" referred to "a structure which encloses wholly or partially some piece of property so as to impede ingress and egress. It may be composed of anything so long as it creates a line of obstacle serving this purpose." This was confirmed by Clancy J in the British Columbia Supreme Court in the case of *Barrow v Landry* [1998] BCJ No 1601.

15. In addition, in *Barrow v Landry*, Clancy J stated at [21] to [22]:

> To take the narrow view suggested by Mr. Landry would not be of assistance in attaining the objects of the *Act*. **I see no reason to limit the definition of "fence" as that word is used in the *Act* to some upright, above ground, structure that encloses an area of property. I conclude that a structure of any kind, provided it serves the purpose of either enclosing property or separating contiguous estates is a fence within the meaning of the *Act*.** I find as well that it is unnecessary, as contended by Mr. Landry, that the fence be constructed for the specific purpose of dividing the property into two distinct portions. It seems to me to be sufficient if the structure serves that purpose. [Emphasis added]

16. In the old case of *Ellis v Arnison* (1822) 1 B&C 70, 107 ER 27, the court considered whether a ditch was a fence according to an Inclosure Act. The court concluded (at 74):

> Whatever provisions the General Inclosure Act may have very wisely introduced, **yet we cannot say that a ditch may not be in legal construction a fence**; and

> if it may be, then the jury in this case have found that this ditch was a sufficient fence, in the judgment of the commissioners. The verdict must, therefore, be entered for the defendant on this issue.
>
> [Emphasis added]

17. In *Helding v Davis* [1911] VLR 74 the plaintiff and the defendant owned adjoining blocks of land. Mr Davis's land was enclosed on three sides by post and wire fences, and on the fourth side by a gully 8 to 15 feet deep. The gully was impassable to ordinary cattle, except at one place where a track had been cut across it and fenced with barbed wire. The gully formed the boundary between the plaintiff's and defendant's lands. One of Mr Helding's heifers was found in Mr Davis's crop of peas. Mr Davis impounded the heifer and refused to release it to Mr Helding until Mr Helding paid the trespass rate for "trespasses on land enclosed with a substantial fence". Mr Helding argued that the gully was not a substantial fence and therefore a lesser trespass rate was payable (for trespass on land not tillage land enclosed with a substantial fence). Hood J in the Supreme Court of Victoria decided:

> I cannot say that my mind is entirely free from doubt, but I think that the justices were at liberty to say that this was a fence….The authorities referred to by Mr. Ah Ket show that a ditch may be a fence, and the *Inclosure Act* referred to in *Ellis v Arnison* speaks of land bounded "by any river or other sufficient fence." I think, therefore, the word fence is used in the *Pounds Act* 1890 to describe an obstruction to the passage of trespassing cattle of such a kind as in the opinion of the magistrates is a substantial barrier to their ingress.

18. In *Bass Coast SC v Coastal Estates Pty Ltd* [2008] VCAT 1518, the Victorian Civil and Administrative Tribunal cited the above passage in *City of Greater Geelong v Herd* and stated (at [57]):

> The cases referred to included discussion of the purposes of fences including that they are normally to enclose specific areas, or to define them. Such areas may not be limited to the area within a title boundary. **Orchard fences, internal paddock fences, cattleyards, tennis courts and so on may enclose particular areas**. [Emphasis added]

19. These cases show that the purposes of a fence include any (or a combination) of the following:

- to enclose an area;
- to define boundaries; and
- to provide a barrier and prevent ingress or egress.

In addition, these cases show that the ordinary meaning of "fence" need not be limited to some upright, above ground, structure, and that any kind of structure may potentially be a fence as long as it forms a barrier or encloses land (*Barrow v Landry; Lahey v Hartford Fire Insurance Co*).

Does a cattle stop come within the meaning of "construction on the land of fences" under s DO 1(1)(f)?

20. The purpose of a cattle stop is to form a barrier for stock while still allowing people and vehicles access to the area without the need to open and close a gate. The main function of a cattle stop, when used in conjunction with a fence, is to form a barrier for stock and prevent their escape (even though people and vehicles can still enter and exit the enclosed area). In the context of a farming or agricultural business, a means of entry and exit is generally a necessary part of a fenced enclosure.

21. Section DO 1 refers to certain costs incurred in carrying on a farming or agricultural business in New Zealand. Section DO 1(1)(f) allows a deduction for expenditure incurred on the construction on the land of fences for farming or agricultural purposes. Apart from the expenditure needing to be for the "construction" of fences, the provision neither places any restrictions on, nor provides any further guidance as to, the meaning of "fence". As discussed above, dicta in the case law suggest that the ordinary meaning of "fence" need not be limited to upright, above ground structures (*Barrow v Landry, Ellis v Arnison, Helding v Davis*). Based on the case law, it would seem that a structure, such as a cattle stop, may come within the meaning of "fence" as long as it encloses land or forms a barrier to ingress or egress. However, it is not entirely free from doubt. In such cases it is necessary to consider the scheme and purpose of the legislation.

22. The Commissioner considers that there is nothing in the Act to suggest that a cattle stop constructed in an opening of a fence cannot come with the meaning of "construction on the land of fences" in s DO 1(1)(f). When a cattle stop is used, as part of a fence, to bar stock from entering and exiting a fenced enclosure, the Commissioner considers that the cattle stop is sufficiently fence-like to come within the meaning of "construction on the land of fences". This is because, in that situation, the cattle stop is an integral part of the barrier formed by the fence.

23. In addition, a cattle stop may be considered an alternative to a gate. A gate, when shut, continues the line of a fence and bars entry or exit. A cattle stop also continues the line of the fence, but it bars only livestock from entering or exiting the fenced area. In addition, the definition of "fence" in the Fencing Act

1978 shows that gates (and, by analogy, cattle stops) may be considered to come within the meaning of "fence" in some contexts.

24. A strict view of the meaning of the word "fence" might not include cattle stops (or gates). However, when the case law and the scheme and purpose of the legislation is considered, the Commissioner is satisfied that a wider definition applies in s DO 1(1)(f), provided that the cattle stop is used "to fence" and is part of a fence. Where a cattle stop is constructed in an opening in a fence, expenditure on the cattle stop will be deductible under s DO 1(1)(f) as being "construction on the land of fences".

References

Related rulings/statements
IS0025 "Dairy farming – Deductibility of certain expenditure" *Tax Information Bulletin* Vol 12, No 2 (February 2000)
Subject references
Cattle stop, deductibility, farming expenditure, fence
Legislative references
Income Tax Act 2007, s DO 1(1)(f)
Case references
Barrow v Landry [1998] BCJ No 1601 *Collins v Wooff* [2010] NZEnvC 227 *Ellis v Arnison* (1822) 1 B&C 70, 107 ER 27 *Helding v Davis* [1911] VLR 74 *Kontikis v Schreiner* (1989) 16 NSWLR 706, 68 LGRA 301 *Lahey v Hartford Fire Insurance Co* [1968] OR 727

QB 12/04: INCOME TAX – DEDUCTIBILITY OF EXPENDITURE ON WIDENING OR METALLING A FARM ACCESS ROAD OR TRACK

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

This QWBA applies in respect of s DO 4 and sch 20.

The item "Expenses Allowable To Farmers Who Convert To Tanker Collection" was published in *Public Information Bulletin* No 20, p 11 (March 1965) ("the old PIB item"). This QWBA updates and replaces the parts of the old PIB item that relate to metalling and widening of farm roads and tracks. 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. The Commissioner's view on the other parts of the old PIB item that are still relevant are set out in the following items: QB 12/03: Income tax – deductibility of expenditure on cattle stops; Operational Statement 007: Income tax treatment of certain expenditures on conversion of one farming or agricultural purpose to another; and Interpretation Statement IS0025: Dairy farming – deductibility of certain expenditure. As a result, the old PIB item is no longer current and should not be relied on. 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. A farmer decides to improve a farm road or track by laying metal or widening the road or track. How is the expenditure treated for income tax purposes?

Answer

2. The cost of widening or metalling the farm road or track is a capital expense because it substantially alters the nature of the track. Section DO 4 allows for an amortisation-type deduction for capital farm expenditure listed in sch 20. Item 4 in sch 20 refers to the "construction of access roads or tracks to or on the land". The widening or metalling of the farm road or track is the construction of an access road or track under item 4. So the cost of widening or metalling the farm road or track can be deducted on a diminished value basis at 6%.

3. If a farmer relays metal on a previously metalled farm road or track, or re-widens a farm road or track to return it to its former condition, the expenditure will be deductible under s DA 1.

Explanation

4. 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 (s DA 1). Expenditure that is capital in nature cannot be deducted under the general permission because of the capital limitation (s DA 2(1)). Various factors are relevant in determining whether expenditure is capital in nature: *BP Australia Ltd v C of T (Cth)* [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* (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 the asset 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.

5. Therefore, if a taxpayer relays metal on a previously metalled farm road then the expenditure will be deductible under s DA 1. Likewise, if a taxpayer re-widens a road to return it to its former condition the expenditure will be deductible under s DA 1. The re-widening may be needed due to a slip or plant growth.

6. There are also some specific deduction provisions for farm expenditure in subpart DO. The specific provisions override the capital limitation. As a result, if the farm expenditure is capital in nature, it may be deductible under one of the specific provisions.

7. Section DO 4 allows for an amortisation-type deduction for farm expenditure listed in sch 20. The requirements to obtain a deduction under s DO 4 are as follows (as relevant):

> **DO 4 Improvements to farm land**
>
> **When this section applies**
>
> (1) This section applies when—
>
> (a) a person carries on a farming or agricultural business on land in New Zealand; and
>
> (b) an improvement described in schedule 20, part A (Expenditure on farming,

horticultural, aquacultural, and forestry improvements) has been made to the land; and

(c) the expenditure on the improvement is not expenditure to which sections DO 5 to DO 7 apply.

Deduction: expenditure: owner of land

(2) A person who owns the land is allowed a deduction for expenditure to which all the following apply:

(a) it is incurred on making the improvement; and

(b) it is incurred by the person or by another person; and

(c) it is not incurred on anything described in any of sections DO 1 to DO 3; and

(d) it is incurred in the 1995–96 income year or in a later income year, not including the income year in which the person disposes of the land, the income year being the income year of the person who owns the land; and

(e) it is incurred in developing the land; and

(f) it is of benefit to the business in the income year in which the person is allowed the deduction.

Deduction: expenditure: non-owner of land

(3) A person who does not own the land is allowed a deduction for expenditure to which all the following apply:

(a) it is incurred on making the improvement; and

(b) it is incurred by the person; and

(c) it is not incurred on anything described in any of sections DO 1 to DO 3; and

(d) it is incurred in the 1995–96 income year or in a later income year, not including the income year in which the person ceases to carry on the business on the land; and

(e) it is incurred in developing the land; and

(f) it is of benefit to the business in the income year in which the person is allowed the deduction.

...

Link with subpart DA

(7) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

8. Item 4 in sch 20 provides as follows:

4 construction of access roads or tracks to or on the land

9. The ordinary meaning of item 4 includes the construction of a new farm road or track (including metalling the road or track) within s DO 4. This is consistent with an answer to a previous question on the deductibility of expenditure for establishing an access track in *Tax Information Bulletin* Vol 7, No 13 (May 1996): 24.

10. However, an issue arises whether the widening or metalling of an existing farm road or track comes within the term "construction" in item 4. The issue turns on whether the term "construction":

- is limited to the initial building of the road or track, or
- extends to any subsequent improvements to the road or track.

Ordinary meaning of "construction"

11. The ordinary meaning of "construction" (the *Oxford English Dictionary* (online ed March 2012, 2nd edition, Oxford University Press, 1989, accessed 21 March 2012)) is:

> **construction, n.** I. The action of constructing. 1. a. The action of framing, devising, or forming, by the putting together of parts; erection, building.
>
> **construct, v.** 1. a. trans. To make or form by fitting the parts together; to frame, build, erect.

12. A similar definition was adopted by the Environment Court in *Waitakere City Council v Minister of Defence* [2006] NZRMA 253 in the context of the Resource Management Act 1991.

13. Therefore, the ordinary meaning of "construction" has a broad meaning that includes building, erecting and fitting parts together. It is considered that the ordinary meaning of "construct" extends to building a subsequent addition to an asset or thing.

Does the purpose of the farming expenditure regime indicate a meaning of "construction"?

14. The phrase "construction of access roads or tracks to or on the land" was initially enacted in 1950 as part of a previous regime for farm expenditure. The original purpose behind the farming expenditure provisions was to encourage primary production and the development of farm land. It is arguable that the initial focus was on the development of newly acquired land or land that was being broken in for a farm. The farm expenditure regime was subsequently amended in 1963 and then again in 1986 and 1991. It appears that by 1963 (and even more so by 1991) the focus seems to have broadened to encourage specific types

of farm expenditure. In other words, it appears that the incentive was no longer limited to breaking in farm land. Therefore, the Commissioner considers the re-enactment of the farm expenditure regime in the ITA 2007 was to continue to encourage the specific types of farm expenditure. The nature of the incentive is arguably more supportive of a broad definition of "construction". In other words, as Parliament wanted to encourage farm expenditure it is more likely that Parliament intended additional improvements be included within the scope of "construction".

Does the context of the relevant provisions suggest a meaning of "construction"?

15. The context of the relevant provisions suggests the word "construction" extends to any subsequent improvements to a road or track. Specifically:

- Section DO 4 refers to "improvements to farm land". A subsequent widening or metalling of a road or track could be seen as a farm "improvement".
- Section DO 1 is another farm expenditure provision. Section DO 1 allows for the deduction of certain farm expenditure. Section DO 1(1)(f) uses the term "construction" in relation to rabbit-proofing an existing fence. Schedule 20 sets out the various types of farm expenditure and the relevant rates. Schedule 20 also uses the term "construction" in relation to rabbit-proofing an existing fence. Therefore, s DO 1 and sch 20 arguably link the word "construction" with the upgrading of an existing fence. Such an interpretation tends to support the conclusion that the word "construction" is not limited to initial construction.
- The various definitions of "construction" and "construct" in other enactments are broad. Specifically, the definitions of "construction" or "construct" in s 2 of the Electricity Act 1992, s 2 of the Public Works Act 1981, s 2 of the Local Government Act 1974 and s 7 of the Building Act 2004 appear to extend to subsequent additions.

Consequences of a narrow interpretation of "construction"

16. The likely consequence of a narrow interpretation of "construction" is that the cost of the widening or metalling would be black hole expenditure. Given the incentive nature of the farm expenditure regime, it is unlikely that Parliament intended the cost of the widening or metalling to be black hole expenditure. So the consequence of the narrow interpretation is also supportive of a broader interpretation of the term "construction".

References

Related rulings/statements
Public Information Bulletin No 20 (March 1965) 11 *Tax Information Bulletin* Vol 7, No 13 (May 1996) 24
Subject references
Dairy farming, deductibility, income tax, metalling and widening existing farm road
Legislative references
Income Tax Act 2007, s DO 4, sch 20
Case references
BP Australia Ltd v C of T (Cth) [1965] 3 All ER 209 *Christchurch Press Company Ltd v CIR* (1993) 15 NZTC 10,206 *CIR v Birkdale Service Station Ltd* (2000) 19 NZTC 15,981 (CA) *CIR v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 14 NZTC 9,101 (CA) *CIR v Wattie* (1998) 18 NZTC 13,991 (PC) *Waitakere City Council v Minister of Defence* [2006] NZRMA 253

QB 12/05: INCOME TAX – DEDUCTIBILITY OF EXPENDITURE ON STOCK YARDS

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

This QWBA applies in respect of s DO 1(1)(f).

This item updates and replaces part of the item "Allowances on Covered Stock Yard" published in *Public Information Bulletin* No 21, p 10 (April 1965) that relates to the cost of fencing new stock yards. 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. As to the remainder of that item, please see the item "Stockyard roof – depreciation" published in *Tax Information Bulletin* Vol 7, No 8 (February 1996) and paragraph 24 of this QWBA. For more information about the review, please see "Review of Public Information Bulletins" *Tax Information Bulletin* Vol 23, No 1 (February 2011).

Question

1. A farmer is constructing new stock yards. How is the expenditure on the stock yards treated for income tax purposes?

Answer

2. Where stock yards are not an integral part of a wider asset, the cost of constructing the stock yards is deductible in the year in which it is incurred. Assuming the expenditure was incurred in carrying on a farming or agricultural business on land in New Zealand, the deduction is available under s DO 1(1)(f) as construction on the land of fences.

3. However, where stock yards are an integral part of a wider asset, such as a shearing shed or dairy shed, the stock yards are not "fences" within s DO 1(1)(f). Therefore a deduction is not available for expenditure on the construction of the stock yards incurred in the income year under s DO 1(1)(f). For further information on whether a fence forms part of a wider asset, and discussion of the principles of deductibility in relation to certain farming expenditure, see IS0025 "Dairy farming – Deductibility of certain expenditure" published in *Tax Information Bulletin* Vol 12, No 2 (February 2000): 17.

Explanation

4. Specific farming deductions are available in subpart DO. Section DO 1 (Enhancements to land, except trees) allows an immediate deduction for the expenditure incurred in constructing fences. Section DO 1 overrides the capital limitation. Section DO 1(1) relevantly provides:

> **DO 1 Enhancements to land, except trees**
>
> *Deduction*
>
> (1) A person is allowed a deduction for expenditure that they incur on the following in carrying on a farming or agricultural business on land in New Zealand:
>
> ...
>
> (f) the construction on the land of fences for farming or agricultural purposes, including buying wire or wire netting for the purpose of making new or existing fences rabbit-proof:

5. Assuming the expenditure was incurred in the carrying on of a farming or agricultural business on land in New Zealand, the ability to deduct the expenditure incurred in constructing the stock yards under s DO 1(1)(f) then depends on whether the stock yards are a collection of "fences" within that section. If the stock yards are not a collection of fences, then the deductibility of the expenditure on stock yards is considered under the general rules of deductibility.

What are stock yards?

6. Stock yards are structures that enclose an area to keep livestock within for a particular purpose. Stock yards are built and used for a wide variety of purposes. Such purposes may include loading out (for sales) or receiving (from purchases), for care (such as trimming hooves, veterinary care, drenching, injecting etc), and stock take (counting). Stock yards can be built of different materials, but usually would be of wood, wood and wire or metal (reinforced steel) construction.

7. Depending on the purpose and use of the stock yards, they may be adjacent to a shed (eg, a wool or dairy shed) or some other farm facility. In such a case, it is necessary to determine whether the stock yards and the barrier surrounding the stock yards are part of a wider asset.

What is a "fence"?

8. The *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, New York, 2007) relevantly defines "fence" as follows:

> **fence** noun...**3** a railing or barrier constructed of posts of any of various materials connected by wire, planks, etc., used to enclose and prevent entry to and exit from a field, yard, etc.

9. The dictionary definition shows that the ordinary meaning of the word "fence" is an upright structure that is comprised of posts (of any of various materials) connected by wire or wood. The definition also shows that the purpose of a fence is to enclose an area to prevent or control access to and from that enclosed area.

10. In relation to the rights, duties and liabilities of owners of fences, *Halsbury's Laws of England* (5th edition, 2011) vol 4, Boundaries, provides the following definition of fences at [350]:

> Although fences are frequently used to mark the situation of boundaries, none the less they are primarily guards against intrusion, or barriers to prevent persons or animals straying out, and therefore in this sense the term includes not only hedges, banks, and walls, but also ditches. But an external party wall forming part of a building and alongside or on the boundary of land is not usually regarded as a fence.

11. The word "fence" is also defined in other New Zealand Acts. For example, the Fencing Act 1978 provides the following definitions:

> **Fence** means a fence, whether or not continuous or extending along the whole boundary separating the lands of adjoining occupiers; and includes all gates, culverts, and channels that are part of or are incidental to a fence; and also includes any natural or artificial watercourse or live fence, or any ditch or channel or raised ground that serves as a dividing fence.
>
> **Adequate fence** means a fence that, as to its nature, condition, and state of repair, is reasonably satisfactory for the purpose that it serves or is intended to serve

12. While not decided in a tax context, the following cases are useful in that they discuss the ordinary meaning of the word "fence".

13. In the New Zealand Environment Court case of *Collins v Wooff* [2010] NZEnvC 227, the court, was prepared to contemplate a wider range of fences than typical post and wire fencing when considering what the phrase "standard rural fencing" meant. This was in the context of a resource consent that contained a fencing covenant requiring the defendant to only erect "standard rural fencing" on his property. However, the defendant's case failed because he could not show that the 8 metre stone wall he had erected next to his driveway performed the function of a fence. The court was not persuaded that the fencing covenant necessarily ruled out stone walls because such structures were commonly used as fences on farms in other parts of New Zealand. However, in this case, the wall was not a "fence" because it did not form a barrier or enclose anything. In the court's view the function of a fence is to form a barrier or enclose an area of land.

14. Similarly, in *Kontikis v Schreiner* (1989) 16 NSWLR 706, 68 LGRA 301 the Court of Appeal of the Supreme Court of New South Wales considered that for a structure to be a fence, the structure must not merely bound land in fact but must be there functionally or essentially for that purpose.

15. In *Lahey v Hartford Fire Insurance Co* [1968] OR 727 at [6], the Ontario High Court of Justice considered that "fence" referred to "a structure which encloses wholly or partially some piece of property so as to impede ingress and egress. It may be composed of anything so long as it creates a line of obstacle serving this purpose". This was confirmed by the British Columbia Supreme Court in the case of *Barrow v Landry* [1998] BCJ No 1601.

16. In *City of Greater Geelong v Herd* 94 LGERA 149, Batt J, in the Administrative Appeals Tribunal (Victoria), considered the ordinary meaning of "fence" and stated (at 172–173):

> To my mind, the two essential features are the function of enclosing or barring and location along or serving to define a boundary: cf Kontikis v Schreiner (1989) 16 NSWLR 706; 68 LGRA 301, which, I acknowledge, was concerned with the definition in the dividing fences legislation of New South Wales. **Lest I be misunderstood I hasten to say that the boundary need not be that of a total property or parcel of land, but can be the boundary of some lesser unit. However, it must be, in my view, the boundary of something that has or at any rate once had physical unity. Thus one can have within a domestic property a fence along the boundary of a vegetable patch, a tennis court, a swimming pool or a chicken coop, to take a few examples.**
>
> [Emphasis added]

17. In *Bass Coast SC v Coastal Estates Pty Ltd* [2008] VCAT 1518, the Victorian Civil and Administrative Tribunal cited the above passage in *City of Greater Geelong v Herd* and then stated (at [57]):

> The cases referred to included discussion of the purposes of fences including that they are normally to enclose specific areas, or to define them. Such areas may not be limited to the area within a title boundary. **Orchard fences, internal paddock fences, cattleyards, tennis courts and so on may enclose particular areas**. [Emphasis added]

18. These cases show that the purposes of a fence include any (or a combination) of the following:
    - to enclose an area;
    - to define boundaries; and
    - to provide a barrier and prevent ingress or egress.

    In addition, the cases show that a boundary defined by a fence need not be the entire parcel of land or total property; it can be the boundary of some lesser unit (*City of Greater Geelong v Herd; Bass Coast SC v Coastal Estates Pty Ltd*).

Are stock yards a collection of "fences" for the purposes of s DO 1(1)(f)?

19. The above discussion shows that a "fence" could be any structure that performs the function or has the purpose of a fence, or it could refer only to structures that are commonly called fences and that fit the dictionary definition of "fence". The Commissioner considers that there is nothing in the Act to suggest that stock yards cannot come within the reference to "fences" in s DO 1(1)(f). Section DO 1 refers to certain costs incurred in carrying on a farming or agricultural business in New Zealand. Apart from the expenditure needing to be for the "construction of fences" the provision neither places any restrictions on, nor provides any further guidance as to, the meaning of "fence". In addition, dicta in the case law suggest that a small enclosure, such as a cattle yard, can be described as being surrounded by "fences".

20. Stock yards are an area of land enclosed by what are essentially fences. Stock yards can be smaller than some paddocks, but according to case law the size of an enclosure does not affect whether something is a fence: *City of Greater Geelong v Herd; Bass Coast SC v Coastal Estates Pty Ltd*. This is consistent with the definition of "fence" in the *Shorter Oxford English Dictionary*, which states that a fence is "used to enclose and prevent entry to and exit from a field, yard, etc". In addition, in *Bass Coast SC v Coastal Estates Pty Ltd*, the Tribunal made some obiter comments on the nature of fences and specifically referred to cattle yards as falling within the meaning of "fence".

21. Therefore, the Commissioner considers that stock yards will be a collection of "fences" for the purposes of s DO 1(1)(f).

22. However, as identified in IS0025, sometimes stock yards are attached to other assets, such as dairy sheds or shearing sheds. IS0025 was concerned with ss DO 3 and DO 4 of the Income Tax Act 1994, the precursors to ss DO 1 and DO 4 of the Income Tax Act 2007 (s DO 4 no longer provides for fences). IS0025 concluded (at 30):

    > Separate expensing for the pipe work, bails and rails, in terms of section DO 3, is not available. Although it is accepted that the word "fence" has a wide ordinary meaning, it is necessary to take into account the context in which the word is used in the legislation, the nature of a dairy shed, views expressed in cases regarding the integrated nature or entirety of assets, and the legislative background. Given these considerations, on balance, the pipe work forms part of the dairy shed asset itself and is not a "fence" under section DO 3 or section DO 4 [of the Income Tax Act 1994].

23. The Commissioner considers that where stock yards form part of a wider asset, the stock yards would not satisfy s DO 1(1)(f).

Covered stock yards

24. Sometimes, a roof or cover is constructed over a stock yard. The item "Allowances on Covered Stock Yard", published in *Public Information Bulletin* No 21, p 10 (April 1965), was primarily about covered stock yards. For the Commissioner's view on the tax treatment of a stock yard roof, please see the item "Stockyard roof – depreciation" in *Tax Information Bulletin* Vol 7, No 8 (February 1996). Please note that the calculation method in s DO 4 and the rate in Sch 20 have changed since *Tax Information Bulletin* Vol 7, No 8 (February 1996) was published. Under the current legislation, the cost of constructing a stock yard roof can be amortised on a diminished value basis at 12% under s DO 4 and Sch 20, Item 13, as expenditure incurred on the construction of a structure for shelter purposes.

References

Related rulings/statements
IS0025 "Dairy farming – Deductibility of certain expenditure" *Tax Information Bulletin* Vol 12, No 2 (February 2000) "Stockyard roof – depreciation" *Tax Information Bulletin* Vol 7, No 8 (February 1996)
Subject references
Deductibility, farming expenditure, fence, stock yard
Legislative references
Income Tax Act 2007, s DO 1(1)(f)
Case references
Barrow v Landry [1998] BCJ No 1601 *Bass Coast SC v Coastal Estates Pty Ltd* [2008] VCAT 1518 *City of Greater Geelong v Herd* 94 LGERA 149 *Collins v Wooff* [2010] NZEnvC 227 *Kontikis v Schreiner* (1989) 16 NSWLR 706, 68 LGRA 301 *Lahey v Hartford Fire Insurance Co* [1968] OR 727

QB 12/06: FRINGE BENEFIT TAX – "AVAILABILITY" BENEFITS

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

This QWBA applies in respect of ss CX 2(1) and CX 37.

Question

1. If an employer makes a good or service available to an employee, will the mere availability of the good or service be a fringe benefit?

Answer

2. No. Fringe benefits arise when a benefit is **provided** by an employer to an employee in connection with their employment. Once a benefit has been provided to an employee, it is irrelevant if it is never used, it will be a fringe benefit (subject to any exclusions in subpart CX applying). However, the "mere availability" of goods or services that have not been provided will not be a fringe benefit.
3. Motor vehicles are dealt with differently to other goods or services; the availability for private use of a motor vehicle will give rise to a benefit by virtue of s CX 6.
4. Whether or not the availability for private use of a business tool (which by definition has been provided to an employee) is a fringe benefit depends on whether it falls within the exclusion in s CX 21.

Explanation

5. A fringe benefit is, broadly speaking, a benefit that an employer provides to an employee in connection with their employment.
6. We have been asked whether, under the Act, the mere availability of a good or service to an employee is sufficient to be a fringe benefit.

Legislation

7. The relevant provisions of the Act, ss CX 2(1), CX 6, CX 21 and CX 37, are as follows:

CX 2 Meaning of fringe benefit

Meaning

(1) A **fringe benefit** is a benefit that—

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

(b) either—

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

(ii) is an unclassified benefit; and

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

CX 6 Private use of motor vehicle

When fringe benefit arises

(1) A fringe benefit arises when—

(a) a motor vehicle is made available to an employee for their private use; and

(b) the person who makes the vehicle available to the employee—

(i) owns the vehicle:

(ii) leases or rents the vehicle:

(iii) has a right to use the vehicle under an agreement or arrangement with the employee or a person associated with the employee.

Exclusion: work-related vehicles

(2) Subsection (1) does not apply when the vehicle is a work-related vehicle.

Exclusion: emergency calls

(3) Subsection (1) does not apply when the vehicle is used for an emergency call.

Exclusion: absences from home

(4) Subsection (1) does not apply when the employee is absent from home, with the vehicle, for a period of at least 24 hours continuously, if the employee is required, in the performance of their duties, to use a vehicle and regularly to be absent from home.

Use on part of day

(5) For the purposes of subsections (3) and (4), the whole of the day on which a motor vehicle is used as described in the applicable subsection is treated as a day on which the vehicle is not available for private use.

CX 21 Business tools

When use of business tool not fringe benefit

(1) The private use of a business tool that an employer provides to an employee, and the availability for private use of such a business tool, is not a fringe benefit if—

(a) the business tool is provided mainly for business use; and

(b) the cost of the business tool to the employer, including the amount of any deduction for the cost of the business tool that the employer may make under section 20(3) of the Goods and Services Tax Act 1985, is no more than $5,000.

Use away from employer's premises

(2) For the purposes of subsection (1), a business tool that is not taken to and used on the employer's premises may nevertheless be provided mainly for business use if the employee

> performs a significant part of the employee's employment duties away from the premises.
>
> **CX 37 Meaning of unclassified benefit**
>
> **Unclassified benefit** means a fringe benefit that arises if an employer provides an employee with a benefit in connection with their employment that is—
>
> (a) not a benefit referred to in any of sections CX 6 to CX 16; and
>
> (b) not a benefit excluded under this subpart.

Application of the legislation

8. The provision of a benefit by an employer to an employee will only be a "fringe benefit" for the purposes of the Act if it comes within s CX 2. This section requires that:
   - a benefit must be provided by an employer to an employee in connection with their employment; and
   - the benefit must fall within s CX 2(1)(b), and not be excluded from being a fringe benefit by any other provision.
9. To fall within s CX 2(1)(b), a benefit must either arise as described in any of ss CX 6, CX 9, CX 10, or CX 12 to CX 16 of the Act, or be an unclassified benefit. Sections CX 9, CX 10 and CX 12 to CX 16 deal with the actual *provision* of particular specified benefits, and an unclassified benefit arises if an employer *provides* an employee with a benefit in connection with their employment. However, s CX 6 states that a motor vehicle that is **made available** to an employee for their private use will give rise to a fringe benefit. The issue we have been asked to consider is whether other goods or services that are merely made available for an employee to use privately will also give rise to a fringe benefit. In other words, where goods or services are made available for an employee to use, has a benefit been provided by the employer to the employee in connection with their employment?

Requirement for there to be a "benefit"

10. The Act does not define the term "benefit" for the purposes of the fringe benefit tax (FBT) rules. Therefore, this word is to be read as having its ordinary meaning.
11. "Benefit" is defined (relevantly) in the *Concise Oxford English Dictionary* (12th edition, Oxford University Press, New York, 2011) as "an advantage or profit gained from something".
12. This broad definition of "benefit" could cover a situation where an employer makes something available to an employee, even though the employee may not yet have used the thing in question. Even if something has not been used, the fact of it being **available** is an advantage or benefit, in contrast to it not being available.
13. However, there is judicial authority which indicates that there are limits to when something which is, strictly speaking, an "advantage" will be considered to be a benefit for FBT purposes.
14. In *Case M9* (1990) 12 NZTC 2,069, the Taxation Review Authority (TRA) considered the FBT status of contributions to a superannuation fund and the provision of motor vehicles that were available for the private use and enjoyment of two employees.
15. The TRA noted that the legislation specifically provided that the availability for private use or enjoyment of a motor vehicle would be a fringe benefit. The TRA went on to say, on the general meaning of "benefit" (at 2,074):

    > The section itself to an extent explains what is a benefit, for the purposes of a fringe benefit; so long as something is provided by an employer to an employee **that can be reasonably, practically and sensibly understood as a benefit to the employee in itself** and is not expressly excluded, [that] would be sufficient for it to be a benefit for the purposes of the definition of "fringe benefit" as provided by the section. [Emphasis added]

16. While the legislative provision considered in *Case M9* was a predecessor to s CX 2, the principles remain relevant as the definition of "fringe benefit" still requires that a benefit be provided by an employer to an employee.
17. Accordingly, the Commissioner is of the view that a particular "advantage" must be sufficiently clear and definite that it can reasonably, practically and sensibly be understood as a tangible benefit.

Requirement for the benefit to be "provided"

18. The term "provided" is also not defined in the Act and so is to be read as having its ordinary meaning.
19. "Provide" is defined (relevantly) in the *Concise Oxford English Dictionary* as:

    > **v. 1** make available for use; supply. ➤(**provide someone with**) equip or supply someone with

20. A number of cases have discussed the meaning of the word "provide". These cases show that the meaning of "provide" depends on the facts and circumstances of each case. For example, in *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414 at 422, Pearson J stated:

    > I do not think that there is any hard and fast meaning of the word "provided"; it must depend on the circumstances of the case as to what is "provided" and how what is "provided" is going to be used.

21. In *Norris v Syndi Manufacturing Co Ltd* [1952] 1 All ER 935 at 940, Romer LJ stated:

> The primary meaning of the word "provide" is to "furnish" or "supply" ...

22. In *Pierce v FCT* 98 ATC 2,240, the Australian Administrative Appeals Tribunal considered whether a car had been provided to an employee. At 2,247, BJ McMahon (Deputy President) stated:

> There is no reason why "provides" should not be given its ordinary English meaning, namely "to furnish or supply" (*Macquarie Dictionary*).

23. Accordingly, for something to have been "provided" to an employee for the purposes of s CX 2, it must be supplied, furnished or made available for use by the employee.

Is the mere availability of a good or service is a fringe benefit?

24. The term "availability", or reference to something having been "made available" or being "merely available", could be used to describe a number of different scenarios where the benefit may or may not have been provided for the purposes of the FBT rules. Common scenarios where people might consider that the concept of "availability" arises, and may regard this as relevant to determining whether FBT is payable, include:
    - Where goods or services have been provided by an employer and the employee may or may not use them;
    - Where goods or services are potentially available to an employee (but not yet provided); and
    - Where business assets may also be used by an employee for private purposes.
25. Each of these scenarios will be considered in turn.

Where goods or services have been provided and the employee may or may not use them

26. If goods or services have been provided by an employer, it is irrelevant whether they are in fact used. The goods or services are a benefit that has been provided and they will be a fringe benefit (the other requirements of s CX 2(1) being satisfied).
27. An example of this is where an employer purchases a number of sports season tickets and provides them to its employees to use. It does not matter whether, or how frequently, the employees use the tickets; the benefits (the tickets) have been provided.
28. Similarly, if an employer purchased gym memberships for its employees, benefits (the memberships) have been provided. It is not accurate to describe the memberships as being merely available; they have been purchased and provided to the employees. Whether a benefit has been provided to the employees is not dependent on whether any given employee actually goes to the gym. The benefits are the memberships and they have been provided.

Where goods or services are potentially available to an employee (but not yet provided)

29. If no benefit has been provided, there can be no fringe benefit. The availability of a good or service must be considered in a reasonable, practical, and sensible way to determine whether it is, in itself, a benefit (*Case M9*).
30. Arguably the availability of goods or services on offer from an employer is itself a benefit. However, the Commissioner considers that where there is simply the option of accessing goods or services, a fringe benefit does not arise until that option is taken up and the goods or services in question are provided. While there is some benefit in having something available to be taken up, this cannot reasonably, practically or sensibly be considered a benefit for the purposes of the FBT rules.
31. For example, if an employer makes the option of purchasing discounted goods available to its employees, this would not constitute the provision of a benefit in terms of s CX 2. There is merely an opportunity for the employees to be provided with something that would be a benefit for FBT purposes. If an employee takes advantage of the offer to purchase discounted goods, a benefit in terms of s CX 2 would be provided at that point.
32. This is consistent with the conclusion in the discussion document *Streamlining the Taxation of Fringe Benefits* (Government discussion document, Policy Advice Division of Inland Revenue, 11 December 2003) that discounted goods need to be purchased to trigger the taxable benefit. The discussion document states (at page 16):

> **Availability for use versus actual use**
>
> 3.6 If an asset is provided by an employer to an employee, its fringe benefit value is determined by whether it is available for private use. In the case of motor vehicles, the availability test is applied on a daily basis. Whether a vehicle is available for private use can be determined by keeping a log book for a three-month test period (see section CI 11). If the vehicle is available for private use at any time during the day, such as for home-to-work travel, availability for such use is considered to exist for the whole day.
>
> 3.7 If the benefit relates to a service rather than the provision of an asset, the benefit is valued

> according to the actual use of that service, with no value being attributed to having access to the subsidised service. **Discounted goods are similarly treated - even though the discount may be available to the employee at all times, goods have to be purchased to trigger the taxable benefit.**
>
> 3.8 Arguably, the availability of a discount or access to services has some value, but it is very difficult to determine and will vary from employee to employee, depending on whether they intend to purchase the goods or services. Given these difficulties, it is sensible to treat the availability aspect as irrelevant and apply "use" as the appropriate test.
>
> [Emphasis added]

33. As noted in the discussion document, the availability of a discount, or access to services, is of some value and is arguably therefore a benefit. However, consistent with *Case M9*, it is necessary to consider the availability of a good or service in a reasonable, practical, and sensible way to determine whether a benefit can be said to have been provided. The Commissioner considers that the mere availability of a discount, or access to services, cannot reasonably, practically or sensibly be regarded as a benefit in these circumstances.

34. As noted above, motor vehicles are treated differently to other goods or services; the availability for private use of a motor vehicle will give rise to a fringe benefit by virtue of s CX 6.

Where business assets may also be used by an employee for private purposes

35. Some assets of a business that are used by an employee in the performance of their work duties may also be capable of being used for private purposes. In such cases, it is considered that a benefit is only provided when the goods are actually used for private purposes. While the possibility of obtaining a private benefit exists, the business assets are not **provided to the employee**, and no benefit is provided, until they are actually used for private purposes.

36. For example, a yacht charter company owns a number of yachts. If the yacht charter company allows its employees to use its yachts on Mondays, when the company is closed for business, the yachts will not be provided to the employees until they actually take them out for private use. Until then there is simply an opportunity to use the yachts for private purposes. This is arguably a benefit which has been "provided" and is of some value.

37. However, again consistent with *Case M9*, it is necessary to consider whether the "availability" of the yachts for private use can be reasonably, practically and sensibly regarded as a benefit provided. As with the availability of discounts, or access to services, the Commissioner considers that the mere availability of a business asset for private use cannot reasonably, practically or sensibly be regarded as a benefit provided. On those days when an employee actually uses a yacht for private purposes, however, a benefit will be provided and it will be a fringe benefit.

38. Another example of business assets that may also be used for private purposes are DVDs available for staff at a DVD store to take home free of charge as they wish. The mere availability of the DVDs for private use would not be considered a benefit provided. It would only be on occasions when employees took DVDs home that a benefit would be provided, and would constitute a fringe benefit.

39. As already noted, the availability for private use of a motor vehicle is different. The availability for private use of a motor vehicle will give rise to a fringe benefit under s CX 6 (subject to the exclusions in that section).

Business tools exclusion

40. Some business assets may be **provided to** employees for business purposes, and also be available for private use. Such an asset would be a "business tool", which is defined in s YA 1 as "an item that is used by an employee in the performance of their work duties and in the absence of s CX 21 (Business tools) would give rise to an unclassified benefit". Examples of business tools include items such as mobile phones or laptops given to employees that are also able to be used for private purposes.

41. Whether the availability for private use of a business tool is a fringe benefit depends on whether it falls within the exclusion in s CX 21. Section CX 21 provides that neither the private use nor the availability for private use of a business tool will be a fringe benefit if: (1) the business tool is provided mainly for business use; and (2) the (GST-inclusive) cost of the business tool to the employer is no more than $5,000. Business tools that do not fall within this exclusion will be subject to FBT.

Tax Information Bulletin item from 1995

42. The item "FBT – Meaning of 'availability for private use or enjoyment'" *Tax Information Bulletin* Vol 6, No 10 (March 1995), considered whether benefits, other than a motor vehicle, that were available for private use and enjoyment would be fringe benefits under the Income Tax Act 1976 ("the 1976 Act").

43. The 1995 item concluded that the mere availability for private use or enjoyment of an employee benefit other than a motor vehicle would not be a fringe benefit under the 1976 Act. The item stated that a benefit other than a motor vehicle would be a fringe benefit only if the employee had actually "used, enjoyed, or received" the benefit in relation to, in the course of, or by virtue of the employee's employment.

44. For the reasons discussed above, a good (not being a motor vehicle) or service that has not been provided but is "merely available" will not constitute a fringe benefit. This QWBA clarifies what was meant in the 1995 item by the term "mere availability".

45. Fringe benefits arise when a benefit is **provided** by an employer to an employee in connection with their employment. Once a benefit has been provided, it is irrelevant if it is never used. The crucial question is whether the benefit has been provided by the employer to the employee. The concept of "availability", or something having been "made available" or being "merely available", could be used to describe a number of different scenarios where the benefit may or may not have been provided for the purposes of the FBT rules. However, if a good or service has in fact been provided, it is inaccurate to describe it as being "merely available".

BR Pub 09/07

46. The commentary to BR Pub 09/07 "Provision of benefits by third parties – fringe benefit tax consequences – section CX 2(2)" touches briefly on the question of what constitutes a benefit. Paragraphs [100], [101] and [103] of that discussion may be read as suggesting that in order for there to be a "benefit" for FBT purposes something must be provided to the employee, and the employee must actually use or takes advantage of the thing provided. Those paragraphs of the commentary to BR Pub 09/07 should not be relied on to the extent that they may suggest this and be inconsistent with this QWBA.

47. It is noted that the comments in the commentary to BR Pub 09/07 which incorrectly suggest that something provided must be used or taken advantage of to be a benefit do not in any way alter the conclusions reached in BR Pub 09/07.

Conclusion

48. If goods or services have been provided to an employee by an employer, it is irrelevant whether they are in fact used. The goods or services are a benefit that has been provided, and they will be a fringe benefit (the other requirements of s CX 2(1) being satisfied, and subject to any exclusion applying).

49. Where goods or services are potentially available to an employee (but not yet provided), there is simply the option of accessing those goods or services. A benefit is not provided until that option is taken up and the goods or services in question are provided.

50. Where business assets (which are neither business tools provided to an employee, nor motor vehicles) may also be used by an employee for private purposes, a benefit is only provided when the goods are actually used for private purposes. While the possibility of obtaining a private benefit exists, the goods are not **provided to the employee** as a benefit until they are actually used for private purposes; rather, the goods are provided for work purposes and the benefit is provided when they are used privately.

51. Whether the availability for private use of a business tool that has been provided to an employee is a fringe benefit depends on whether it falls within the exclusion in s CX 21. Section CX 21 provides that neither the private use nor the availability for private use of a business tool will be a fringe benefit if: (1) the business tool is provided mainly for business use; and (2) the (GST-inclusive) cost of the business tool to the employer is no more than $5,000.

52. The availability for private use of a motor vehicle (whether a business asset or not) will generally give rise to a fringe benefit under s CX 6.

References

Subject references
Benefit, availability, potential benefit
Legislative references
Income Tax Act 2007, ss CX 2(1), CX 6, CX 21 and CX 37
Case references
Case M9 (1990) 12 NZTC 2,069 *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414 *Norris v Syndi Manufacturing Co Ltd* [1952] 1 All ER 935 *Pierce v FCT* 98 ATC 2,240
Other references
"FBT – Meaning of 'availability for private use or enjoyment'" (*Tax Information Bulletin* Vol 6, No 10 (March 1995)) BR Pub 09/07 "Provision of benefits by third parties – fringe benefit tax consequences – section CX 2(2)" *Streamlining the taxation of fringe benefits* (Government discussion document, Policy Advice Division of Inland Revenue, 11 December 2003)

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.

CLAIM MUST PROVIDE CLARITY AS REQUIRED

Case	Chesterfields Preschools Limited & Ors v Commissioner of Inland Revenue
Decision date	9 March 2012
Act(s)	High Court Rules
Keywords	Strike out, pleadings, clarity

Summary

The Court decided that to consider the strike-out application, the case must be re-pleaded to provide clarity of issues and claim.

Impact of decision

The decision confirms that the Court will hear a case based on any reasonable grounds but will strike out a malicious prosecution tort if the issues involved were not ultimately found in the plaintiffs favour.

Facts

The Commissioner of Inland Revenue ("the Commissioner") applied to strike out Chesterfields Preschools Limited & Ors ("the plaintiffs") claim for damages for malicious prosecution of civil proceedings.

The plaintiffs are associated with David John Hampton and have been property-holding companies and operators of pre-schools involved in longstanding litigation with the Commissioner.

The malicious prosecution claimed by the plaintiffs related to liquidation proceedings and summary judgment proceedings against the plaintiffs.

Strike-out application

The Commissioner submitted that:

- the liquidation proceedings were not resolved in favour of the plaintiffs;
- the plaintiffs' claim that the liquidation proceedings were set aside is unsustainable;
- each proceeding (save CIV-2000-409-803) was discontinued but in the context that the company had either accepted a liability and paid money or would do so;
- it had withdrawn the CIV-2000-409-803 proceeding in light of doubt as to the nature and extent of the debt claimed, with the Commissioner paying a sum of money on account of costs;
- a debt was due and owing and the winding-up of the relevant company was sought.

The plaintiffs opposed the Commissioner's application by alleging that:

- Fogarty J's judgment in *Chesterfields Preschools*[1] (judicial review) had, "by implication", set aside the liquidation proceedings; and
- the summary judgment proceedings were permanently set aside by the judicial review proceeding and therefore resulted in favour of the plaintiffs.

At issue was whether the Court should strike out all or some of the causes of action advanced by the plaintiffs.

Decision

After analysing the relevant principles[2], submissions[3] and case law[4], his Honour Associate Judge Osborne found that the proceedings could not arguably amount to a determination in favour of the plaintiffs and that the only tenable claim was in one liquidation proceeding.

His Honour highlighted that there had been no judgment in favour of the plaintiffs and that each summary judgment proceeding remains adjourned[5].

[1] *Chesterfields Preschools Ltd v Commissioner of Inland Revenue* (2007) 23 NZTC 21,125.

[2] Paragraph [18].

[3] Paragraphs [11], [24], [28], [29], [32], [33], [34] and [43].

[4] Paragraph [22].

[5] Paragraphs [40] and [43].

His Honour also found that debts were paid by the plaintiff to the Commissioner, (satisfactory arrangements were also made) and thus, the substantive outcome in each proceeding (save CIV-2000-409-803) was in favour of the Commissioner. Accordingly, seven of the eight proceedings were struck out.

Reference to the plaintiffs' statement of claim and its lack of clarity was also mentioned[6]:

> There are paragraphs which by their nature do not lend themselves to a clear response by way of defence because separate and distinct facts are not stated separately and clearly as required by r 5.17(1).

Ultimately, the plaintiffs were ordered to:

- file and serve (through a practising solicitor) an amended statement of claim in which the preserved cause of action is pleaded; or
- if Mr Hampton is to continue to represent Chesterfields Preschools Limited, then he must file and serve a representation memorandum with a draft of the amended pleading.

ORDERS SETTING ASIDE DISPOSITIONS OF PROPERTY MADE UNDER SECTION 348 OF THE PROPERTY LAW ACT 2007

Case	Commissioner of Inland Revenue v Ly & Ors
Decision date	16 March 2012
Act(s)	Property Law Act 2007
Keywords	Dispositions of property, prejudice to a creditor

Summary

The properties were disposed of without a reasonably equivalent value being received in exchange and as a consequence the debtors became insolvent. The dispositions were also made with the intent to prejudice the Commissioner of Inland Revenue as a creditor, and had the effect of hindering or delaying the Commissioner's recourse to those properties to satisfy the debt.

Facts

Hon and Ta Ly purchased a residential property in Taumaranui ("the Miriama St property") and a bakery business in Taumaranui ("the Taumaranui Bakery") in 1999. The Taumaranui Bakery was operated by the Hon and Ta Ly partnership.

In 2003, they also purchased a bakery business in Whakatane ("the Whakatane Bakery"). This business was operated by Hon Ly as a sole trader. Hon and Ta Ly also purchased a residential property in Auckland in April 2003 ("the Sunset Rd property") by way of loan assistance from friends and a mortgage from BNZ.

In 2006, Hon and Ta Ly, as trustees of the Hon and Ta Ly Family Trust, purchased the building from which the Taumaranui Bakery business was conducted ("the Hakiaha St building") with funding from The New Zealand Guardian Trust Company Ltd.

The Commissioner initiated an audit of both businesses in July 2008. As a consequence of that audit, assessments for PAYE, GST, Working for Families Tax Credits and income tax were made against Hon and Ta Ly. These assessments were not challenged by either Hon Ly or Ta Ly and constituted a debt owed to the Commissioner.

On 16 April 2009, Vandra Ly (Hon and Ta Ly's daughter) purchased the Miriama St and Sunset Rd properties for $120,000 and $430,000 respectively with a $50,000 deposit apportioned as $25,000 for each property. The balance owed for the Miriama St property was left owing to Hon and Ta Ly under an unsecured term loan and the balance for the Sunset Rd property was met partly by mortgage funding and the rest by an unsecured term loan from Hon and Ta Ly. No payments were made towards the term loans.

On 21 April 2009 both the Taumaranui Bakery and the Whakatane Bakery were sold to Vandra Ly Limited (a company established by Vandra Ly) for $35,000 and $113,000 respectively by way of a further term loan agreement. Both businesses were subsequently sold to unrelated third parties in 2010.

On 9 June 2009, Vandra Ly sold the Miriama St property to herself and Thiary Ly (Vandra Ly's sister) as trustees of the Vandra Ly Family Trust for $100,000. The Sunset Rd property was also transferred to the Vandra Ly Family Trust (the transfer was registered on 23 December 2010). Hon and Ta Ly remained in residence pursuant to an agreement to pay rent. However, no rent was paid.

On 10 June 2011, the Commissioner issued proceedings seeking judgment for the debt owed. The Commissioner also sought orders under section 348 of the Property Law Act 2007 ("PLA") in respect of the Miriama St and Sunset Rd properties on the basis these dispositions had prejudiced the Commissioner as creditor. Further, the Commissioner sought freezing orders in respect of those properties and the additional Hakiaha St building.

[6] Paragraph [48].

Freezing orders were granted albeit the Sunset Rd property was sold on 4 December 2011 (with the proceeds held by the Registrar of the High Court pending judgment).

Issues

The issues were whether:

- the dispositions were made with the intent to prejudice a creditor (section 346(1)(b) of the PLA);
- the dispositions did prejudice the Commissioner as creditor (section 348(1)(b) of the PLA);
- the respondents had made out any of the defences set out in section 349 of the PLA; and
- any further orders (compensation for Vandra Ly) could be made under section 350(3) of the PLA.

Decision

Andrews J stated there was no dispute that the transfers were dispositions (section 345(2) of the PLA) and that Hon and Ta Ly became insolvent as a consequence of those dispositions (section 346(2) of the PLA).

Her Honour was guided by the Supreme Court judgment in *Regal Castings Ltd v Lightbody* [2008] NZSC 87; [2009] 2 NZLR 433 and on the basis of a number of factors (in particular the fact only $50,000 had ever been paid for the properties, no rent had been paid by Hon and Ta Ly, the debt had been forgiven to the extent possible and the Commissioner had not been advised of the transfers) Andrews J considered the transfers were made without a reasonably equivalent value being received in exchange.

Andrews J also considered that the transfers were made with the intent to prejudice the Commissioner as creditor, particularly as Vandra Ly confirmed she was aware Hon and Ta Ly owed the Commissioner a substantial debt and that she wanted to preserve their assets and further that Hon and Ta Ly knew that by transferring the Miriama St and Sunset Rd properties they removed themselves from any ability to pay the debt. Her Honour was satisfied the transfers had the effect of hindering or delaying the Commissioner's recourse to those properties to satisfy the debt and therefore exposed the Commissioner to a significantly enhanced risk of not recovering the debt. Accordingly, Andrews J considered the transfers fell within subpart 6 of the PLA and therefore could consider whether orders should be made under section 348.

Despite counsel for the respondents submitting during the hearing there was no prejudice to the Commissioner as Vandra Ly could pay the outstanding loan balances, Andrews J did not accept there could be no prejudice to the Commissioner. Her Honour considered that the Commissioner had been hindered or delayed in the exercise of his right of recourse to the properties as he has had to apply for orders under section 348 and incur costs and delay in doing so.

Her Honour also considered that the available defences under section 349 of the PLA had not been made out by the respondents particularly given valuable consideration was not given for the properties and that Vandra Ly had knowledge of the fact these were dispositions to which subpart 6 of the PLA would apply.

While the respondents had sought an order for compensation to Vandra Ly for payments she has made to assist her parents, rent payable for the period her parents resided in the Sunset Rd property and the benefit of the increase in value of the Sunset Rd property since its transfer to Vandra Ly, Andrews J did not consider it appropriate that Vandra Ly benefit from retaining the properties.

DEBTOR-INITIATED PAYMENTS

Case	Stiassny & Ors v Commissioner of Inland Revenue
Decision date	15 March 2012
Act(s)	Goods and Services Tax Act 1985, Personal Property Securities Act 1999
Keywords	Debtor-initiated payments, consideration, good faith, restitution, mistake of law

Summary

The Court of Appeal considered the issues of debtor-initiated payments under section 95 of the Personal Property Securities Act 1999 ("PPSA") and how such payments effected priorities and claims in restitution for payments made by mistake. The Court of Appeal found that not only had the Commissioner of Inland Revenue ("the Commissioner") provided good consideration, but he had also acted in good faith in receiving payment of goods and services tax ("GST") from the receivers. The Court of Appeal dismissed the Appellants' appeal.

Impact of decision

This decision, although significant in terms of quantum has limited tax technical implications. However, the decision is very significant for its analysis of section 95 of the PPSA dealing with debtor-initiated payments and how it relates to the law of restitution regarding mistaken payments.

Facts

The respondents in this case are:

- two companies, who were partners in the Central North Island Forestry Partnership ("CNIFP") and the receivers of those companies

- the secured creditors of the CNIFP.

The partner companies were each placed in receivership by a secured creditor. The CNIFP itself was not in receivership.

The CNIFP sold a forest for US$621 million, plus GST of approximately NZ$127 million. There were insufficient funds to repay secured lenders as well as the GST on the sale, which resulted in a dispute as to the priority of the GST amount. The receivers paid the GST to the Commissioner and commenced proceedings to claim the funds back. The respondents sought:

- an order that the receivers were not liable to pay the GST
- the return of the funds as money paid under a mistake of law (a restitutionary claim).

The Commissioner applied to strike out the claim in the High Court.[1] The Court found in favour of the respondents. The Commissioner subsequently appealed the High Court's decision to decline to strike out the respondents' claim to the Court of Appeal.

The issues for the Appeal were:

1. whether the receivers were liable for the GST
2. whether section 95 of the PPSA operates so as to confer priority to the Commissioner over any claim the respondents have to the GST
3. whether the respondents could recover the GST from the Commissioner on the basis it was paid under a mistake of law namely that the receivers were personally liable to pay the GST.

Decision

The Court of Appeal affirmed the decision made by the High Court that the receivers were not liable to pay the GST; the liability was that of the partnership.

The Court of Appeal was not persuaded by the Commissioner's argument that the combined relevant purposes of sections 57 and 58 of the Goods and Services Tax Act 1985 ("GST Act") are to achieve efficiency and to ensure that a receiver pays the registered person's GST liabilities during a receivership.

> We are not persuaded that this interpretation is available to the Commissioner and agree with Mr Simcock's submissions on this issue. First, this interpretation would require the notional insertion of words in s 58 which are not there. Secondly, and more importantly, this approach would directly contradict s 57(2)(a) which provides that partners shall not be registered persons. The Commissioner's approach would mean that partners in a partnership were effectively made registered persons in respect of the partnership's taxable activities whenever the partners went into receivership, despite the clear wording of s 57(2)(a). Thirdly, such an interpretation is not "required" because the Commissioner has a secondary right of recovery against the members of the partnership by virtue of s 57(3) and (5). [24]

The Court of Appeal held that the GST Act contemplates that primary liability for the payment of GST falls on the unincorporated body as the registered person. Secondary liability under subsections 57(3) and (5) falls only upon the members of that body:

> The section does not, for example, provide that directors or executives of a company which is a member of a partnership might become liable for GST because they somehow participate in the taxable activities of the partnership. Secondly, the GST Act provides that receivers only become personally liable to pay GST in the carefully defined circumstances of s 58, which we have found do not apply here.

The Court of Appeal held that the receivers were not carrying on the taxable activities of the partnership:

> Thirdly, although the receivers manage the partner companies and, through them, the affairs of the partnership, it does not follow that they are deemed for the purposes of the GST Act to be carrying on the taxable activities of the partnership. The partnership (CNIFP) continues to conduct its own activity for GST purposes and, as such, is primarily liable for the payment of GST. [27]

The Court of Appeal agreed with the High Court that the payment of GST by the receivers to the Commissioner was a debtor-initiated payment within the meaning of section 95 of the PPSA on the footing that the receivers, as agents for the two partners (and through them the CNIFP), initiated payment to the Commissioner:

> ... Importantly too, the payment was made from funds belonging to the CNIFP and with the express consent of the BNZ on behalf of the senior secured creditors. There is no question that the CNIFP owed the GST sum to the Commissioner whether or not the receivers may have believed they were also personally liable for payment of this sum. [67]

Whether the security interests had crystallised and whether the payment was made in the ordinary course of business were not relevant to the operation of section 95. The payment was a debtor-initiated payment, notwithstanding it was paid under compulsion or pressure as a result of exposure to interest and penalties:

> ... There is nothing in the language or purpose of s 95 which requires that a gloss be placed on the meaning of the term "debtor-initiated payment". There can be no question here but that the payment was initiated by or on behalf of the debtor in the sense that a conscious decision was taken by

[1] *Stiassny v Commissioner of Inland Revenue* HC Auckland CIV-2008-404-549, 4 November 2010.

> the receivers to forward a cheque to the Commissioner for the amount of the GST liability. The fact that they did so because they believed that they were or might be personally liable for the amount of the GST concerned could not justify the conclusion that the payment was other than debtor-initiated. Although the payment was made for motives associated with the sanctions for late payment imposed by the relevant statutory regime, it could not be said that the payment thereby lost its debtor-initiated status. [72]

The Court also considered it was a factor that the members of the partnership, the receivers and the BNZ as the security trustee for the senior secured creditors all agreed that GST should be paid from the sale proceeds and authorised the receivers to proceed accordingly. The Court also noted that:

> We add that the receivers no doubt required the purchaser to pay GST on the purchase price so they would have the necessary funds to discharge the GST liability to the Commissioner. At the time the payment was made, it was never contemplated that the secured creditors would receive the windfall benefit of the GST collected on the sale of the partnership assets.

The Court of Appeal did not accept the respondents' submission that the issue of whether this was a debtor-initiated payment should have been left for trial rather than being dealt with on a strike-out application.

> ... This was a straightforward issue capable of ready determination as a matter of law on the undisputed facts before the Court. Counsel did not elaborate on what further factual material might have been relevant. [71]

The Court of Appeal concluded that the Commissioner was prima facie entitled to priority over the secured creditors in relation to the GST payment subject to the possibility of *in personam* claims.

The Court of Appeal found that not only had the Commissioner provided good consideration, but that he had also acted in good faith in receiving payment of the GST from the receivers. The Court rejected an argument by the receivers that the CNIPF (through its member companies) had no authority to make the GST payment as the payment was made with the express authority of the BNZ as the security trustee for the secured creditors and, more importantly, section 95 of the PPSA recognises that a debtor is entitled to make a payment to a creditor notwithstanding the existence of a security interest over the assets from which payment is made.

The Court of Appeal confirmed the approach of the High Court that defences to a restitutionary remedy may include the giving of good consideration by the payee or alteration of position by the payee and concluded that:

> It is unnecessary for us to enter further into this debate other than to note that the giving of good consideration has been accepted as a proper ground upon which a court may determine that the defendant has not been unjustly enriched. This follows on the simple footing that, if the defendant is entitled to the money, then it cannot be said to be unjust, or against conscience, to require repayment. [94]

The Court found that there was no suggestion that the Commissioner knew of the receiver's mistaken belief that they were personally liable to pay GST. The issue was whether mere notice of an adverse claim is sufficient to demonstrate an absence of good faith on the part of the Commissioner. The Court considered that the current authorities and academic commentary were of no real benefit because they had no direct relevance to where the defence is that the Commissioner gave good consideration for the payment. Accordingly the Court found:

> All the Commissioner has done in the present case is to receive the GST payment in the belief that it was properly due, a view which was shared at the time by the receivers and their advisers. Although the Commissioner was advised prior to the making of the payment that the secured creditors claimed to be entitled to the money, there is no suggestion that the Commissioner doubted his entitlement or had reason to believe there was a likelihood he would have to repay the money. Indeed, he rejected the Notice of Proposed Adjustment later issued by the receivers under the Tax Administration Act and has consistently maintained the view that he is entitled to the payment. [105]

The Court of Appeal also made a further point, not addressed by counsel, that it may be inappropriate to engraft good faith requirements upon the statutory regime under the Tax Administration Act 1994 for the resolution of disputes of this kind. The Court explained that:

> When the Commissioner receives a payment of GST he does so with the knowledge that any dispute over liability to pay the GST is subject to the dispute resolution processes under that Act. Absent dishonesty or some other wrongdoing, no question of bad faith arises.

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