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TAX INFORMATION Bulletin

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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.

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Binding rulings

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The Supreme Court has dismissed Mr Russell's application for leave to appeal the decision of the Court of Appeal.

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No taxable activity 31

The taxpayer objected to its input credit claims being disallowed and being deregistered for GST. The taxpayer did not prove it had a taxable activity and its other grounds of objection (sham, onus on the Commissioner, bad faith and malicious harassment) were all rejected.

No taxable activity 32

The taxpayer objected to its input credit claims being disallowed and being deregistered for GST. The taxpayer did not prove it had a taxable activity and its other grounds of objection (sham, onus on the Commissioner, bad faith and malicious harassment) were all rejected.

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Commissioner successful in her strike-out application 37

The Commissioner was successful in having the disputant's claim struck out. The disputants may seek leave from the Taxation Review Authority to file an amended claim disputing the correctness of the Commissioner's assessments.

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The Commissioner was awarded indemnity costs on the basis that some of the Trinity investors acted vexatiously, frivolously, improperly, or unnecessarily in commencing and continuing with their unsuccessful application to debar Crown Law from acting for the Commissioner.

BINDING RULINGS

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

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

PRODUCT RULING BR PRD 12/04: NEW ZEALAND MĀORI ARTS AND CRAFTS INSTITUTE

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by the New Zealand Māori Arts and Crafts Institute (the Institute).

Taxation Law

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

This Ruling applies in respect of section CW 36.

The Arrangement to which this Ruling applies

The Arrangement is the Institute's payment of a scholarship to students enrolled in the bone, stone and pounamu carving school Te Takapū o Rotowhio (Te Takapū). Te Takapū runs a two-year diploma (pōkairua) in bone, stone and pounamu carving. Further details of the Arrangement are set out in the paragraphs below.

1. The New Zealand Māori Arts and Crafts Institute Act 1963 established the Institute. Under the 1963 Act, the purpose of the Institute is to operate as a showcase for Māoritanga with an emphasis on displaying aspects of Māori culture to tourists. The Institute is also charged with furthering the development of carving in a traditional manner.
2. Since 1967, the Institute has awarded two types of qualification, the New Zealand Māori Arts and Crafts Institute Diploma and New Zealand Māori Arts and Crafts Institute Certificate.
3. In 1994, a "needs analysis" of the Institute was undertaken. As a result of the analysis, the Institute decided to refocus its activities on training and educating Māori. To this end, the Institute awards Te Takapū o Rotowhio Pōkairua (the Diploma), a diploma in bone, stone and pounamu carving.
4. To be awarded the Diploma, students must complete 10 modules. Each module carries a designated number of credits. Students need 360 credits to complete the course. The modules and their levels and credits are as shown in the table below.

No	Name of module	Level	Credits
1	Studio Practice 1	4	45
2	Technical Skills 1	4	45
3	Studio Practice 2	5	45
4	Technical Skills 2	6	35
5	Research 1	5	40
6	Research 2	6	30
7	Introduction to Small Business Planning for the Creative Industries	4	30
8	Marketing for the Creative Industries	5	35
9	Basic Finance for the Creative Industries	6	20
10	Small Business Planning and Practice for the Creative Industries	6	35

5. The Institute has trained student carvers since 1967. In 2011, three students were enrolled in the first intake of year 1 of the Diploma. During 2012, three students have progressed to year 2 and two new students have been recruited to year 1.

Scholarship Agreement and Scholarship Policy

6. The Institute offers a limited number of scholarships to help students (tauira) while they are studying. The Scholarship Agreement (the Agreement) entered into between the Institute and its tauira has the following features:

- Each scholarship is for the amount of $18,200 per year paid in weekly sums over a two-year term. The amount of the annual scholarship payment may be adjusted from time to time to reflect changes in the Consumers Price Index.
- The Agreement sets out the hours of class attendance required by tauira, terms and study periods.
- The Agreement states that the Institute will provide a uniform and tools for tauira.
- Any carvings or other items tauira produce during their studies are the property of the Institute.

7. The scholarship payments help to cover the living costs of tauira. Tauira have generally moved from their tribal area, are young and have few assets. The Institute covers all costs of training, protective clothing, tools, equipment and raw materials.
8. The Institute also has a scholarship policy, which is set out below:

Scholarship Policy

i) The Māori Arts and Crafts Institute now offers student scholarships to successful applicants to Te Takapū o Rotowhio.

ii) Scholarships will be offered annually to successful applications to Te Takapū o Rotowhio and the number of students will be determined or negotiated between the Institute and Te Wānanga.

iii) Scholarships will be awarded to a successful applicant for one year of study upon recommendation of the interview panel.

iv) A review of year one will be undertaken encompassing the student's achievements and compliance with Te Wānanga and New Zealand Māori Arts and Crafts Institute Policies.

v) The Scholarship awarded for all students is $18,200.00 per annum.

vi) Award payments will be made weekly in an effort to assist students budget adequately for the year.

vii) Award payments will be direct credited to student bank accounts and record of payments identified through student bank statements.

viii) Te Wānanga reserves the right to terminate a student's scholarship with one week's notice of such termination, for serious breaches of Wānanga/Institute policies and dismissal through misconduct.

a) Students will, for the first three months of their first year with Te Wānanga, move through a probation period. During this time Te Wānanga staff and students will determine suitability/ability to cope with the course challenges.

b) Termination of a student's scholarship may also be the result of the student's inability to fully complete Module assignments or practice tasks described within the Wānanga's curriculum to prescribed standards and within given time-frames.

c) Students who wish to terminate their scholarships may do so either during the probation period or by giving one week's notice of such termination in writing.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

a) Scholarship payments that the Institute makes to a student pursuant to the Arrangement will be exempt income of the student under s CW 36.

The period for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2011 and ending on 31 March 2016.

This Ruling is signed by me on the 28th of August 2012.

James Mulcahy
Investigations Manager, Assurance

LEGISLATION AND DETERMINATIONS

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

DETERMINATION CFC 2012/03: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

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

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

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). TOWER Insurance Limited has made application in respect of the CFC set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFC to which this determination applies is:

Name	Jurisdiction
TOWER Insurance (Cook Islands) Limited	Cook Islands

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2009–10 to 2012–13 income years.

This determination is signed by me this 10th day of October 2012.

John Trezise
Investigations Manager

DETERMINATION PROV24: PROVISIONAL DEPRECIATION RATE FOR MUSHROOM FACTORY BUILDINGS AND PLANT

The Commissioner has been asked to review the estimated useful life and depreciation rate applicable to specialised buildings and plant used to grow mushrooms on a commercial basis. These assets consist of composting buildings (that may include bunkers that are contained within the building); phase 2 pasteurisation buildings (that may include separate mushroom spawning tunnels that are contained within the building), and growing buildings (that may include separate mushroom growing tunnels that are contained within the building), and are constructed predominantly of structural insulated panels ("SIP"). Non-SIP areas are usually constructed with concrete walls and floors, cement panel and colour steel or similar material.

The Commissioner accepts that these specialised, mushroom growing buildings and plant are exposed to a wet, humid and corrosive environment due to the material that is used in growing mushrooms and the environment that mushrooms need to grow successfully.

For these reasons the Commissioner is satisfied that the estimated useful life ("EUL") of these specialised buildings and plant (mushroom spawning tunnels and mushroom growing tunnels, when in books separately from building cost) is 33.3 years and has set a provisional depreciation rate for these assets accordingly. It needs to be noted that "Bunkers (concrete)" are already included in the "Building and structures" asset category, with a EUL of 20 years, and may be used by owners of bunkers used in mushroom growing.

Whether bunkers, spawning and growing tunnels are items of plant that are merely contained within a building or part of the building itself will be a question of fact. In deciding how these items should be categorised it is necessary to consider the degree of affixation and integration these items have with the building.

It also needs to be noted that these rates of depreciation do not apply to those buildings that are not directly involved in the mushroom growing process. These buildings (such as staff facilities, workshops and office areas) are not directly affected by the harsh conditions experienced in the specialised buildings and the estimated useful life will remain at 50 years.

Similarly, buildings with an estimated useful life of 50 years that are converted from some other use to mushroom growing cannot be subject to this determination. This change in use may have enabled the owner to apply for a special depreciation determination, on the basis that the change of use of the building has affected the building's estimated useful life. However, with effect from the 2011–12 income year section EE 35(2) of the Income Tax Act 2007 states that the Commissioner is not able to set a special rate of depreciation for buildings. However, if the owner places the specialised plant subject to this determination (bunkers, spawning and growing tunnels) inside an existing building envelope, these items of plant may be depreciated using these new rates.

DETERMINATION PROV24: TAX DEPRECIATION RATES PROVISIONAL DETERMINATION NUMBER PROV24

This determination may be cited as "Determination PROV24: Tax Depreciation Rates Provisional Determination Number PROV24".

1. Application

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

This determination applies for the 2012 and subsequent income years.

2. Determination

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

- adding into the "Building and structures" asset category, the provisional asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

"Building and structures" asset category	Estimated useful life (years)	DV rate (%)	SL rate (%)
Mushroom factory (purpose built, predominantly in prefabricated stressed skin insulation panels), acquired before 19 May 2005	33.3	6	4
Mushroom factories (purpose built, predominantly in prefabricated stressed skin insulation panels), acquired on or after 19 May 2005	33.3	4.5	3

- adding into the "Agriculture, horticulture and aquaculture" industry category, the provisional asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

"Agriculture, horticulture and aquaculture" industry category	Estimated useful life (years)	DV rate (%)	SL rate (%)
Mushroom growing tunnels (when in books separately from building cost)	33.3	6	4
Mushroom spawning tunnels (when in books separately from building cost)	33.3	6	4

3. Interpretation

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

This determination is signed by me on the 1st day of October 2012.

Rob Wells
LTS Manager, Technical Standards

SPECIAL DETERMINATION S22: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO A PUBLIC-PRIVATE PARTNERSHIP

This determination may be cited as Special Determination S22: "Application of the financial arrangements rules to a public-private partnership".

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

1. This determination relates to an arrangement (the Project) involving the design, construction and ongoing provision of operation and maintenance services in respect of a prison by a certain company (the Company) under a public-private partnership agreement (the Project Agreement) with the Crown. The Company is a wholly-owned subsidiary of Holdings. The Company and Holdings are members of a consolidated group.
2. The Project Agreement comprises three basic components:
   - a construction phase under which the Company agrees to design and construct the prison for the Crown in consideration for a fixed lump-sum payment (the Construction Phase);
   - the lease of the completed prison by the Crown to the Company in consideration for a rental prepayment (the Lease); and
   - a services phase under which the Company will provide operation and maintenance services to the Crown over a 25-year term in consideration for monthly payments (the Services Phase).
3. The Company will enter into:
   - a Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the prison in consideration for capped monthly payments;
   - an Operation and Maintenance Contract with a service provider (the Service Provider), under which the Service Provider will provide the ongoing operation and maintenance (and other) services in consideration for monthly payments; and
   - an Asset Management Agreement with the Service Provider, under which the Service Provider will provide management and administrative services to the Company and Holdings in consideration for periodic payments.
4. The Company will borrow funds (the Senior Debt) from a consortium of banks (the Banks). The Company will enter into interest rate swaps in respect of the Senior Debt (the Swaps). Holdings will also borrow money from a single shareholder during the Construction Phase (the Shareholder Pre-subscription Loan), and each of the other shareholders shall provide an investment support in the form of a standby letter of credit (LC) and/or cash collateral to be held in equity collateral accounts of Holdings (ECA) (for each Deferred Investor). Holdings will also borrow from each of its shareholders during the last part of the Construction Phase and during the Services Phase in the form of optional convertible notes (the Notes).
5. The Services Phase of the Project Agreement, Construction Agreement, Operation and Maintenance Contract, Asset Management Agreement and Lease are all excepted financial arrangements. The Construction Phase of the Project Agreement, Senior Debt, Swaps, Shareholder Pre-subscription Loan, Notes and investment support represented by LCs and/or cash collateral in the ECAs are financial arrangements to which Holdings and/or the Company is a party. The Project, including all of these agreements, is a wider financial arrangement.
6. This determination prescribes:
   - the amount of consideration that is solely attributable to the Lease;
   - how the financial arrangements rules apply to the Construction Phase of the Project Agreement, Services Phase of the Project Agreement, Construction Agreement, Operation and Maintenance Contract, and Asset Management Agreement;
   - the method for spreading the payments made under the Senior Debt, Shareholder Pre-subscription Loan, Swaps and Notes.

2. Reference

This determination is made under ss 90AC(1)(bb) and 91AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

1. This determination applies to the Company in respect of the Project (more fully described in private ruling BR Prv 12/33 issued on 27 August 2012), including the following agreements:
   - Construction Phase of the Project Agreement, under which the Company agrees to design and construct the prison for the Crown and will receive a fixed lump-sum payment (which will be equal to and offset against the rental prepayment referred to below), once the prison is ready for operation.

LEGISLATION AND DETERMINATIONS

- Services Phase of the Project Agreement, under which the Company will provide ongoing operation and maintenance services for 25 years to the Crown in consideration for monthly payments.
- Lease in respect of the prison, under which the Company will lease the prison from the Crown for 25 years and will prepay the rental to the Crown. This payment will be equal to and will offset the payment in relation to the Construction Phase.
- Construction Agreement, under which the Contractor will design and build the prison and receive capped monthly payments from the Company.
- Operation and Maintenance Contract, under which the Service Provider will provide services in respect of the prison and receive monthly payments from the Company.
- Asset Management Agreement, under which the Service Provider will provide management and administrative services to the Company and Holdings in consideration for periodic payments.
- Senior Debt, under which the Company will borrow an agreed sum from the Banks during the Construction Phase for a term of 7 years from financial close of the Project (Financial Close). Interest will be capitalised during the Construction Phase and payable at a market rate thereafter. It is intended that the Senior Debt will be refinanced within 7 years, and every 5 years thereafter over the term of the Project. While the Base Case has assumed 5-yearly refinancings, the Company has flexibility to refinance at any time. As at the date of this determination there is no intention to deviate from the Base Case. Under IFRS (as the standards apply at the date of this Determination), the Senior Debt (and any subsequent refinancings) will initially be recognised at fair value, and subsequently measured using the amortised cost/effective interest method (regardless of whether or not hedge accounting is applied), and will not be treated as a hedge of another financial arrangement.
- Shareholder Pre-subscription Loan, under which Holdings will borrow an agreed sum from a shareholder during the Construction Phase for a market rate of interest. It is yet to be determined whether Holdings will treat the Shareholder Pre-subscription Loan, in part, as an equity instrument under IFRS.
- Swaps, under which the Company will pay a fixed rate of interest to the swap counterparties, and receive a floating rate in return. It is intended that each refinancing of the Senior Debt will be matched by an interest rate swap on materially the same terms as the Swaps (the New Swaps).
- Notes, under which Holdings will issue convertible notes to its shareholders for a term of 25 years and 5 months (assuming that the Services Phase commences on the planned date). The Notes will pay an agreed rate of interest quarterly in arrears in cash after the commencement of the Services Phase. If an interest payment is not paid because of insufficient project cash flows, the interest will be capitalised and added to the principal. Any capitalised interest must be paid in cash by the earlier of conversion or expiry (being, 25 years and 5 months, assuming that the Services Phase commences on the planned date). It is intended at the outset that all interest payments will be paid in cash on the quarterly due dates occurring after the commencement of the Services Phase. The Notes are also subject to a fixed inflation adjustment that is added to the principal amount of the Notes each 1 July occurring after the Service Commencement Date. The Notes are redeemable in cash in accordance with an amortisation schedule that amortises the principal to zero over 25 years and 5 months. The Notes are convertible into shares in Holdings at the option of Holdings if Holdings experiences a material cash flow deficit because of events not taken into account in cash flow projections prepared before Financial Close and where conversion of the Notes would assist Holdings to manage its liabilities and solvency (subject to the consent of the Banks). There are no planned conversion dates for the Notes, and there is no fixed intention to convert the Notes before maturity. It is yet to be determined whether Holdings will treat the Notes, in part, as an equity instrument under IFRS.
- Investment support by the Deferred Investors under the Investment Commitment Deed to provide and maintain investment support in the form of a stand-by letter of credit (LC) and/or cash collateral to be held in equity collateral accounts of Holdings (ECA) (for each Deferred Investor). Interest received by Holdings on amounts in the ECA representing a Deferred Investor's cash collateral is, in turn, payable by Holdings to that Deferred Investor (subject to certain criteria). Holdings will pay each Deferred Investor a quarterly fee in arrears (Investment Support Fee) for the period from Financial Close to the Deferred Equity Subscription Date.

2. This determination is made subject to the following conditions:

- The agreed rate of interest payable on the Notes (including the inflation adjustment) will not exceed a rate that would be agreed between wholly unrelated parties having regard to the terms of the Notes and applying orthodox pricing methodologies.
- The Notes will be converted only in circumstances in which the Company and/or Holdings experiences a material cashflow deficit because of events not taken into account in cashflow projections prepared before completion, and where conversion of the Notes would assist the Company and/or Holdings to manage its liabilities and solvency.
- The Company will recognise income derived from the Crown during the Construction Phase of the Project Agreement and the Services Phase of the Project Agreement, and will deduct expenditure incurred in relation to the Lease, Construction Agreement, Operation and Maintenance Contract, and Asset Management Agreement, in each case, under the relevant provisions of the Income Tax Act 2007 (outside of the financial arrangement rules).
- The method applied to determine the income derived and the method applied to determine the expenditure incurred in respect of the investment support represented by cash collateral in each ECA will be the same.
- The continued application of private ruling BR Prv 12/33 (under s 91EB of the Tax Administration Act 1994).

4. Principle

1. The Lease in respect of the prison is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in s EW 5(2) to (16) is not an amount that is taken into account under the financial arrangement rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Lease that are not taken into account under the financial arrangement rules.
2. The Services Phase of the Project Agreement, Construction Agreement, Operation and Maintenance Contract, and Asset Management Agreement are "short-term agreements for sale and purchase", and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in s EW 5(17) to (25) that is part of a financial arrangement is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Company in respect of the Services Phase of the Project Agreement, Construction Agreement, Operation and Maintenance Contract, or Asset Management Agreement are required to be spread under the financial arrangements rules.
3. The Construction Phase of the Project Agreement, Senior Debt, Swaps, Shareholder Pre-subscription Loan, Notes and investment support in the form of LCs and/or cash collateral in the ECAs are "financial arrangements" under s EW 3. This determination specifies that no amounts payable to or by the Company in respect of the Construction Phase of the Project Agreement are required to be spread under the financial arrangements rules, and that the payments made to or by the Company under the Senior Debt, Swaps, Shareholder Pre-subscription Loan and Notes must be spread under the financial arrangements rules in accordance with this determination.

5. Interpretation

1. In this determination, unless the context otherwise requires:

   "IFRS" means International Financial Reporting Standards.

6. Method

1. The prepaid rental the Company will pay in respect of the Lease and the leasehold property interest granted to the Company under the Lease are solely attributable to the Lease, and are not taken into account under the financial arrangement rules.
2. The Company is not required to spread any amounts under the financial arrangements rules in respect of the:
   - Construction Phase of the Project Agreement;
   - Services Phase of the Project Agreement;
   - Construction Agreement;
   - Operation and Maintenance Contract;
   - Asset Management Agreement.
3. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Senior Debt. None of the restrictions for application of this reporting method in s EW 15D(2B) applies.
4. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of any subsequent refinancings of the Senior Debt over the term of the relevant refinancing, provided that the terms of any such refinancings are materially similar to the terms of the Senior Debt. This determination

paragraph does not affect the Company's obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.

5. Determination G3: *Yield to maturity* may be used to allocate the income and expenditure (other than "non-contingent fees" as defined in s YA 1) of the Shareholder Pre-subscription Loan (under s EW 15I if Holdings treats the Shareholder Pre-subscription Loan, in part, as an equity instrument under IFRS, or under s EW 15E if not).

6. The expected value method in s EW 15F may be used to allocate income and expenditure (other than "non-contingent fees" as defined in s YA 1) over the term of the Swaps, provided that the Swaps are not treated under IFRS by the Company as a hedge of other financial arrangements for each of which the Company uses the "fair value method" (as defined in s YA 1). None of the mandatory spreading methods in s EW 15H or s EW 15I applies to the Swaps.

7. The expected value method in s EW 15F may be used to allocate income and expenditure (other than "non-contingent fees" as described in s YA 1) in respect of any New Swaps over the term of the relevant New Swap, provided that the terms of any New Swaps are materially similar to the terms of the Swaps, and further provided that the New Swaps are not treated under IFRS by the Company as a hedge of other financial arrangements for each of which the Company uses the "fair value method" (as defined in s YA 1). None of the mandatory spreading methods in s EW 15H or s EW 15I applies to the New Swaps. This determination paragraph does not affect the Company's obligation to perform base price adjustments under s EW 31 in respect of the Swaps and New Swaps.

8. Determination G3: *Yield to maturity* may be used to allocate the income and expenditure (other than "non-contingent fees" as defined in s YA 1) of the Notes (under s EW 15I if Holdings treats the Notes, in part, as an equity instrument under IFRS, or under s EW 15E if not).

9. If interest payable under the Notes is capitalised in accordance with the terms of the Notes, Holdings must apply the method set out in Determination G25: Variations in the Terms of a Financial Arrangement to calculate income or expenditure under the Notes in the year of variation and subsequent years.

10. This determination does not determine the method that is applied to determine the income derived or expenditure incurred in respect of the investment support represented by LCs and/or cash collateral in the ECAs.

7. Example

This example illustrates the application of the method set out in this determination.

This example is based on the following parameters:

Commencement of Construction Phase	1 April 2013
Completion of Construction Phase	31 March 2017
Completion of Services Phase	31 March 2042
Construction Payment from the Crown	$1,000
Aggregate payments to the Contractor	($850)
Lease Prepayment	($1,000)
Monthly payments from the Crown under the Services Phase	$30
Monthly payments to the Service Provider	($15)
Annual interest on the Senior Debt	($85)
Annual interest on the Shareholder Pre-subscription Loan	($7)
Annual interest (and inflation adjustment) on the Notes	($15)
Annual net payments in respect of the Swaps	($7)

The Company is not required to spread any amounts under the financial arrangements rules in respect of the Lease, Construction Phase of the Project Agreement, Services Phase of the Project Agreement, Construction Agreement, Operation and Maintenance Contract, or Asset Management Agreement.

The amounts that must be spread under the financial arrangement rules are:

- interest on the Senior Debt calculated in accordance with the IFRS financial reporting method in s EW 15D;
- interest on the Shareholder Pre-subscription Loan calculated in accordance with Determination G3: *Yield to maturity*;
- interest on the Notes calculated in accordance with Determination G3: *Yield to maturity*; and
- payments in respect of the Swaps calculated in accordance with the expected value method in s EW 15F.

This determination is signed by me on the 27th day of August 2012.

Howard Davis
Director (Taxpayer Rulings)

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 six months ending 30 September 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 6 months ending 30 September 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 6 months ending 30 September 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 6 months ending 30 September 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 6 months ending 30 September 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)
- 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 6 months ending 30 September 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 2012. Its opening market value on 1 October 2012 or its closing market value on 30 September 2012 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 ÷ 34.8141 = $10,053.40

(In this example, the rate selected is the month-end rate for September 2012 for PHP. Refer to the table "Currency rates 6 months ending 30 September 2012 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 30 June 2012. Branch equivalent income for the period 1 July 2011 to 30 June 2012 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 6.2572 = $31,963.18

(In this example, the rate selected is the rolling 12-month average rate for June 2012 for HKD. Refer to the table "Currency rates 6 months ending September 2012 – rolling 12-month average".)

Example 3

A resident individual with a 30 September 2012 accounting period acquires a FIF interest in a Japanese company on 1 October 2011 for 10,500,000 yen. The interest is sold in September 2012 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 ÷ 63.1043 = $166,391.19

JPY 10,000,000 ÷ 63.1043 = $158,467.80

(In this example, the rolling 12-month rate for September 2012 has been applied to both calculations.)

Example 4

A CFC resident in Singapore was formed on 21 April 2012 and has a balance date of 30 September 2012. During the period 1 May 2012 to 30 September 2012, 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 2012:

   0.9706 + 1.0014 + 1.0077 + 1.0085 + 1.0115 = 4.9997

   4.9997 ÷ 5 = 0.99994

2. Round exchange rate to four decimal places: 0.9999

3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 0.9999 = $500,050.00

(In this example, the rates are from the table "Currency rates 6 months ending September 2012 – mid-month actual", from May to September 2012 inclusive for SGD.)

Currency rates 6 months ending 30 September 2012 – rolling 12-month average

Currency	Code	15/04/2012	15/05/2012	15/06/2012	15/07/2012	15/08/2012	15/09/2012
Australia Dollar	AUD	0.7756	0.7781	0.7797	0.7784	0.7764	0.7754
Bahrain Dinar	BHD	0.3046	0.3040	0.3035	0.3019	0.3011	0.3013
Britain Pound	GBH	0.5092	0.5087	0.5090	0.5080	0.5085	0.5076
Canada Dollar	CAD	0.8039	0.8049	0.8061	0.8062	0.8048	0.8044
China Yuan	CNY	5.1558	5.1342	5.1158	5.0850	5.0700	5.0683
Denmark Kroner	DKK	4.4310	4.4588	4.4909	4.5226	4.5720	4.5957
Euporean Community Euro	EUR	0.5952	0.5991	0.6037	0.6081	0.6147	0.6179
Fiji Dollar	FJD	1.4377	1.4398	1.4437	1.4420	1.4408	1.4410
French Polynesia Franc	XPF	71.0343	71.4931	72.0247	72.5540	73.3537	73.7380
Hong Kong Dollar	HKD	6.2833	6.2713	6.2572	6.2229	6.2041	6.2048
India Rupee	INR	39.2207	39.7541	40.3828	40.8859	41.4728	41.9829
Indonesia Rupiah	IDR	7,166.2517	7,202.1850	7,245.6300	7,268.2742	7,313.9642	7,372.6458
Japan Yen	JPY	63.7342	63.5731	63.2988	62.9743	62.9550	63.1043
Korea Won	KOR	901.8493	904.4890	907.9774	909.6772	910.9124	911.6502
Kuwait Dinar	KWD	0.2234	0.2232	0.2231	0.2225	0.2226	0.2231
Malaysia Ringit	MYR	2.4821	2.4844	2.4879	2.4864	2.4895	2.4890
Norway Krone	NOK	4.6027	4.6221	4.6398	4.6531	4.6759	4.6864
Pakistan Rupee	PKR	71.2495	71.4842	71.8700	72.0970	72.4631	72.9349
Phillipines Peso	PHP	34.9008	34.8319	34.6743	34.4262	34.3162	34.2220
PNG Kina	PGK	1.7647	1.7386	1.7182	1.6942	1.6771	1.6656
Singapore Dollar	SGD	1.0146	1.0138	1.0141	1.0121	1.0128	1.0118
Solomon Islands Dollar*	SBD	5.9179	5.8704	5.8460	5.7928	5.7523	5.7313
South Africa Rand	ZAR	6.1256	6.1976	6.2864	6.3497	6.4133	6.4725
Sri Lanka Rupee	LKR	92.1124	93.1793	94.4852	95.6344	96.9239	98.5057
Sweden Krona	SEK	5.3809	5.4217	5.4458	5.4550	5.4596	5.4606
Swiss Franc	CHF	0.7183	0.7202	0.7251	0.7328	0.7441	0.7484
Taiwan Dollar	TAI	23.8392	23.8570	23.8773	23.8304	23.8594	23.8497
Thailand Baht	THB	24.7847	24.8076	24.8230	24.8003	24.8494	24.8931
Tonga Pa'anga*	TOP	1.3554	1.3508	1.3506	1.3491	1.3522	1.3570
United States Dollar	USD	0.8080	0.8065	0.8049	0.8008	0.7986	0.7991
Vanuatu Vatu	VUV	74.9061	74.9501	75.1358	75.0387	74.8963	74.9445
West Samoan Tala*	WST	1.8184	1.8180	1.8188	1.8149	1.8116	1.8111

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 6 months ending 30 September 2012 – mid-month actual

Currency	Code	15/04/2012	15/05/2012	15/06/2012	15/07/2012	15/08/2012	15/09/2012
Australia Dollar	AUD	0.7935	0.7742	0.7818	0.7787	0.7684	0.7859
Bahrain Dinar	BHD	0.3103	0.2900	0.2972	0.3002	0.3044	0.3125
Britain Pound	GBH	0.5193	0.4810	0.5013	0.5111	0.5147	0.5111
Canada Dollar	CAD	0.8226	0.7749	0.8048	0.8073	0.7985	0.8054
China Yuan	CNY	5.1800	4.8600	5.0100	5.0900	5.1400	5.2400
Denmark Kroner	DKK	4.6811	4.4912	4.6298	4.8353	4.8877	4.7057
Euporean Community Euro	EUR	0.6292	0.6044	0.6233	0.6500	0.6568	0.6314
Fiji Dollar	FJD	1.4577	1.4144	1.4719	1.4611	1.4432	1.4611
French Polynesia Franc	XPF	75.1069	72.1033	74.2906	77.6260	78.4152	75.4066
Hong Kong Dollar	HKD	6.3844	5.9763	6.1151	6.1781	6.2610	6.4265
India Rupee	INR	42.6255	41.7231	43.6433	43.6514	44.8064	45.2998
Indonesia Rupiah	IDR	7601.6100	7168.1900	7413.9200	7489.9300	7658.3500	7943.9800
Japan Yen	JPY	66.5880	61.6850	62.0120	63.0220	63.7550	64.9790
Korea Won	KOR	934.0644	889.1610	918.4702	914.2394	913.4198	925.6619
Kuwait Dinar	KWD	0.2292	0.2147	0.2207	0.2243	0.2282	0.2326
Malaysia Ringit	MYR	2.5325	2.3908	2.4883	2.5254	2.5180	2.5401
Norway Krone	NOK	4.7600	4.6165	4.6916	4.8569	4.7998	4.7130
Pakistan Rupee	PKR	74.6269	69.9301	74.0741	75.1880	76.3359	78.1250
Phillipines Peso	PHP	35.3460	33.1359	33.2237	33.2637	34.0033	34.5590
PNG Kina	PGK	1.6884	1.5743	1.6078	1.6280	1.6628	1.7079
Singapore Dollar	SGD	1.0272	0.9706	1.0014	1.0077	1.0085	1.0115
Solomon Islands Dollar*	SBD	5.9058	5.4461	5.5228	5.6344	5.7436	5.8665
South Africa Rand	ZAR	6.5400	6.3911	6.5824	6.5802	6.6511	6.8031
Sri Lanka Rupee	LKR	106.3830	99.0099	104.1667	106.3830	106.3830	109.8901
Sweden Krona	SEK	5.5889	5.5190	5.5140	5.5986	5.3909	5.4345
Swiss Franc	CHF	0.7564	0.7258	0.7474	0.7807	0.7887	0.7677
Taiwan Dollar	TAI	24.2840	22.7625	23.5439	23.8488	24.2106	24.3278
Thailand Baht	THB	25.3177	24.1145	24.8204	25.1398	25.4504	25.5146
Tonga Pa'anga*	TOP	1.3755	1.3312	1.3706	1.3727	1.3799	1.4065
United States Dollar	USD	0.8228	0.7693	0.7881	0.7959	0.8071	0.8290
Vanuatu Vatu	VUV	76.3359	72.9927	75.7576	75.7576	74.6269	76.3359
West Samoan Tala*	WST	1.8338	1.7649	1.8051	1.8117	1.8153	1.8426

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 6 months ending 30 September 2012 – month end

Currency	Code	30/04/12	31/05/12	30/06/12	31/07/12	31/08/12	30/09/12
Australia Dollar	AUD	0.7847	0.7741	0.7826	0.7699	0.7781	0.8001
Bahrain Dinar	BHD	0.3086	0.2839	0.3020	0.3049	0.3029	0.3130
Britain Pound	GBH	0.5042	0.4891	0.5101	0.5158	0.5063	0.5134
Canada Dollar	CAD	0.8081	0.7783	0.8147	0.8112	0.7925	0.8167
China Yuan	CNY	5.1400	4.8000	5.0900	5.1500	5.1000	5.2200
Denmark Kroner	DKK	4.5994	4.5295	4.7024	4.8908	4.7592	4.8127
Euporean Community Euro	EUR	0.6182	0.6092	0.6329	0.6573	0.6388	0.6457
Fiji Dollar	FJD	1.4514	1.4031	1.4577	1.4436	1.4391	1.4715
French Polynesia Franc	XPF	73.7838	72.6862	75.5392	78.4307	76.2208	77.1030
Hong Kong Dollar	HKD	6.3500	5.8492	6.2164	6.2707	6.2316	6.4369
India Rupee	INR	43.2424	42.3621	44.4714	45.0147	44.5779	43.9706
Indonesia Rupiah	IDR	7534.5800	7172.0500	7532.4600	7662.8600	7650.6600	7999.0200
Japan Yen	JPY	65.3220	59.0310	63.9460	63.1710	62.9750	64.7120
Korea Won	KOR	925.2053	889.7652	914.5292	914.2890	911.0318	923.9166
Kuwait Dinar	KWD	0.2274	0.2115	0.2243	0.2280	0.2265	0.2333
Malaysia Ringit	MYR	2.4854	2.4019	2.5366	2.5340	2.4988	2.5514
Norway Krone	NOK	4.6831	4.6091	4.7763	4.8788	4.6588	4.7541
Pakistan Rupee	PKR	74.6269	70.4225	75.7576	76.3359	75.7576	78.7402
Phillipines Peso	PHP	34.6439	32.8518	33.6545	33.8000	33.6705	34.8141
PNG Kina	PGK	1.6727	1.5405	1.6355	1.6643	1.6516	1.7095
Singapore Dollar	SGD	1.0126	0.9713	1.0140	1.0067	1.0022	1.0188
Solomon Islands Dollar*	SBD	5.7922	5.2880	5.6726	5.7250	5.6875	5.9248
South Africa Rand	ZAR	6.3655	6.4264	6.5423	6.6787	6.7493	6.9034
Sri Lanka Rupee	LKR	106.3830	99.0099	106.3830	106.3830	106.3830	107.5269
Sweden Krona	SEK	5.5025	5.4774	5.5473	5.4987	5.3239	5.4499
Swiss Franc	CHF	0.7427	0.7321	0.7602	0.7897	0.7676	0.7799
Taiwan Dollar	TAI	23.8691	22.4920	23.8964	24.2240	24.0304	24.3427
Thailand Baht	THB	25.1551	23.9864	25.2913	25.4934	25.1375	25.5975
Tonga Pa'anga*	TOP	1.3698	1.3232	1.3928	1.3702	1.3675	1.4124
United States Dollar	USD	0.8185	0.7537	0.8013	0.8087	0.8034	0.8301
Vanuatu Vatu	VUV	75.7576	74.0741	75.1880	74.6269	75.1880	77.5194
West Samoan Tala*	WST	1.8266	1.7560	1.8302	1.8165	1.8176	1.8476

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

NEW LEGISLATION

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

ORDERS IN COUNCIL

STUDENT LOAN SCHEME – CONTACT PERSON DETAILS

The Student Loan Scheme (Details of Borrower's Contact Person) Regulations 2012 specifies two additional pieces of information that the loan manager (StudyLink) must provide to Inland Revenue, to the extent they are available.

As a condition of accessing the student loan scheme for a course of study commencing from 1 January 2013, students will be required to provide the name, address and phone number of an alternate contact person. Applicants may also provide an electronic address.

From 1 January 2013 the Student Loan Scheme Amendment Act 2012 introduces new section 16A to the Student Loan Scheme Act 2011. New section 16A will require the loan manager (StudyLink) to provide details described above to Inland Revenue to the extent that they are available.

These regulations specify two additional pieces of information that the loan manager must provide to Inland Revenue to the extent that they are available. They are:

- the contact person's date of birth; and
- the contact person's tax file number (Inland Revenue number).

Applicants can choose to supply this additional information to StudyLink when they provide the details of their contact person, although it will not be a requirement for accessing the student loan scheme.

Student Loan Scheme (Details of Borrower's Contact Person) Regulations 2012

STUDENT LOAN SCHEME – REPAYMENT PERCENTAGE

The Student Loan Scheme (Repayment Percentage) Regulations 2012 increases the repayment percentage from 10% to 12% for the purposes of the Student Loan Scheme Act 2011.

This increase was announced in Budget 2012 and will come into force on 1 April 2013.

This has the effect of increasing the repayment rate for borrowers with salary or wage income or adjusted net income (for example, business income, rental income and interest) that is over the relevant thresholds to 12 cents in the dollar.

Student Loan Scheme (Repayment Percentage) Regulations 2012

STUDENT LOAN SCHEME – TRANSITIONAL MEASURES FOR NEW BORROWERS

The Student Loan Scheme Act 2011 (Transitional Provisions) Regulations 2012 enables Inland Revenue to grant relief to borrowers who were issued end-of-year assessments for the 2012 tax year as an unintended consequence of changes in the Student Loan Scheme Act 2011. The changes in the 2011 Act replaced the loan transfer at the end of each year and provided for the transfer of loan advance debt from StudyLink to Inland Revenue on a near real-time basis from 1 January 2012.

The early transfer meant a number of borrowers received end-of-year student loan assessments which would not have been issued were it not for the near real-time transfer. In effect, borrowers who had student loans for as little as two or three weeks were sent assessments relating to their entire previous year's income.

The regulation enables Inland Revenue to grant relief to affected borrowers, with effect from 14 September 2012.

Student Loan Scheme Act 2011 (Transitional Provisions) Regulations 2012

STUDENT LOAN SCHEME – VOLUNTEER EXEMPTION

The Student Loan Scheme (Charitable Organisations) Amendment Regulations 2012 adds two organisations to the current list of charitable organisations specified for the purposes of the Student Loan Scheme Act 2011.

The following organisations have been added to the list of specified organisations for the purposes of section 25(1)(b) of the Student Loan Scheme Act 2011, with effect from 1 September 2012:

- Empower Missions Trust Incorporated
- Troppodoc Charitable Trust.

The effect of being listed is that a student loan borrower working overseas as a volunteer, or for a token payment, for such an organisation may be treated, for a period of up to two years, as if they were based in New Zealand. Borrowers who are based in New Zealand qualify for an interest-free loan.

Borrowers must be engaged in one or more of the following activities in order to qualify for the exemption:

- work to relieve poverty, hunger, sickness or the ravages of war, or natural disaster; or
- work to improve the economy of a developing country; or
- work to raise the educational standards of a developing country.

Student loan borrowers seeking the exemption should contact their local Inland Revenue office.

Student Loan Scheme (Charitable Organisations) Amendment Regulations 2012

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 12/12: ABUSIVE TAX POSITION PENALTY AND THE ANTI-AVOIDANCE PROVISION

All legislative references are to the Tax Administration Act 1994 (TAA 1994) unless otherwise stated.

This Question We've Been Asked is about s 141D Abusive tax position. The item answers a question raised about Interpretation Statement IS0061: Shortfall penalty for taking an abusive tax position (*Tax Information Bulletin* Vol 18, No 1 (February 2006): 24).

Question

1. Does the abusive tax position penalty under s 141D apply automatically where there is a "tax avoidance arrangement" under s BG 1 of the Income Tax Act 2007 (s BG 1)? If not, what differentiates a case where s BG 1 applies but the penalty does not?

Answer

2. The abusive tax position penalty under s 141D does not apply automatically where there is a "tax avoidance arrangement". This is because:
   - Section BG 1 requires the tax avoidance purpose or effect of the arrangement to be more than merely incidental. Section 141D requires the dominant purpose to be avoiding tax. Therefore, the tests in the two provisions are fundamentally different.
   - The intention expressed in the pre-legislative material was that the abusive tax position penalty would only apply to "abusive avoidance".
   - The courts have identified that there is a different test under s 141D than under s BG 1.

3. To determine whether the abusive tax position penalty applies it is necessary to decide whether the dominant purpose of the arrangement is avoiding tax. In order to determine that, the tax purposes must be weighed against any other purposes of the arrangement (such as commercial or family purposes) with reference to the specific structure of the arrangement. The presence or absence of certain factors may be relevant in weighing the different purposes. The factors may include artificiality, contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations of tax laws.

Explanation

4. Penalties can be imposed on taxpayers who take incorrect tax positions that result in tax shortfalls. The level of the penalty is intended to reflect the seriousness of the breach. Section 141D applies a 100% penalty where a taxpayer has taken an abusive tax position.

Does the abusive tax position penalty apply automatically where there is a "tax avoidance arrangement"?

5. The abusive tax position penalty under s 141D does not apply automatically where there is a "tax avoidance arrangement" under s BG 1 of the ITA 2007 because:
   - there are different tests in the different provisions,
   - the legislative intent was that the penalty would only apply to abusive tax avoidance, and
   - the courts have recognised the need for a dominant purpose of avoiding tax for an abusive tax position penalty to apply.

There are different tests in the different provisions

Section 141D

6. Section 141D(7) defines an "abusive tax position" as follows:

> (7) For the purposes of this Part and section 177C, an **abusive tax position** means a tax position that,—
>
> (a) is an unacceptable tax position at the time at which the tax position is taken; and
>
> (b) viewed objectively, the taxpayer takes—
>
> (i) in respect, or as a consequence, of an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly; or
>
> (ii) where the tax position does not relate to an arrangement described in subparagraph (i), with a dominant purpose of avoiding tax, whether directly or indirectly.

7. As a result, there are two key requirements for s 141D to apply. Firstly, under s 141D(7)(a) the tax position

must be an "unacceptable tax position". A tax position is an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct: s 141B(1). The unacceptable tax position requirement is discussed in more detail in IS0055: Shortfall penalty – unacceptable interpretation and unacceptable tax position (*Tax Information Bulletin* Vol 17, No 9 (November 2005): 26).

8. Secondly, under s 141D(7)(b) there must be a dominant purpose of avoiding tax. Section 141D(7)(b) provides that an abusive tax position will occur in two situations. The first situation is where the taxpayer takes the tax position in respect of an arrangement with a dominant purpose of avoiding tax: s 141D(7)(b)(i). The second situation is where there is no such arrangement, and the taxpayer has taken the tax position with a dominant purpose of avoiding tax: s 141D(7)(b)(ii). Both of the situations require a "dominant purpose of avoiding tax".

9. This item only discusses the issue of whether the penalty applies where there is a tax avoidance arrangement. This item, therefore, is limited to situations where there is an arrangement under s 141D(7)(b)(i) (and does not discuss s 141D(7)(b (ii)). The courts have held that it is the purpose of the arrangement that is relevant under s 141D(7)(b)(i): *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188 at [207]. Under s 141D(7)(b)(i) "purpose" does not involve any focus on the motives or intentions of the taxpayer.

10. The term "dominant purpose" is not defined in the TAA 1994. The *Oxford English Dictionary* (online ed. updated March 2012, 2nd edition, Oxford University Press, 1989, accessed 28 August 2012) defines "dominant" as follows:

> **1.** governing, commanding; most influential

11. The same dictionary defines "purpose" as follows:

> **1.** **a.** That which a person sets out to do or attain; an object in view; a determined intention or aim.
>
> **2.** The reason for which something is done or made, or for which it exists; the result or effect intended or sought; the end to which an object or action is directed; aim.

12. There are aspects of the ordinary meaning of "purpose" that imply an element of motive or intention. However, the courts have held that the "purpose or effect" of an arrangement in the tax avoidance context is determined objectively: *Newton v FC of T* [1958] AC 450 (PC), *Ashton & Anor v CIR* (1975) 2 NZTC 61,030 (PC) and *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, (2009) 24 NZTC 23,236 at [38]. "Purpose", in the context of tax avoidance, means the intended effect the arrangement seeks to achieve and not the motive of the parties, and "effect" means the end accomplished or achieved by the arrangement.

13. The Court of Appeal discussed the meaning of "dominant purpose" in *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346. Richardson J stated at 6,350:

> Adoption of a dominant purpose test in relation to the particular property purchased allows a sensible focus as a practical matter on what was **truly important** to the taxpayer at the time of acquisition.
>
> [Emphasis added]

14. While the case discusses "dominant purpose" in the context of a provision that refers to the subjective purpose of a taxpayer, the reference to what is "truly important" is considered to be relevant in the current context.

15. Judge Barber commented on the dominant purpose requirement in s 141D in *Case Z1* (2009) 24 NZTC 14,001 as follows at [119]:

> I also find that the disputant entered into the arrangement with the dominant purpose of avoiding tax – refer s.141D(7). The arrangement could not be properly explained by any charitable purpose. The prime objective purpose was to avoid tax (and tax was avoided).

16. Judge Barber, therefore, referred to the dominant purpose as the "prime objective purpose".

17. In *Case Y18* (2008) 23 NZTC 13,180, Judge Barber also discussed "dominant purpose" in s 141D. Judge Barber described "dominant purpose" as an objective test, but arguably relied on subjective factors in applying the test to the facts at issue. As a result, the application of the test to the facts is arguably inconsistent with *Ben Nevis*. However, the discussion of "dominant purpose" is consistent with the other cases. Judge Barber stated at [73]:

> The additional requirement for s 141D to apply, if s 141B already applies, is that, viewed objectively, the dominant purpose of entering into the arrangement was avoiding tax. In *FCT v Spotless Services Ltd & Anor* (1996) 186 CLR 404 (HCA), the High Court of Australia considered the meaning of the "dominant purpose" of enabling a taxpayer to obtain a "tax benefit". It held that: "In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose."

18. Judge Barber referred to *Spotless Services* in interpreting "dominant purpose" in s 141D. The High Court of Australia in *Spotless Services* considered the meaning of "dominant purpose" to be the ruling, prevailing, or most influential purpose.

19. It is considered, therefore, that the purpose is the result or effect intended or sought. The "dominant purpose" is the ruling, prevailing, governing, commanding or most influential or important purpose. The listed terms are synonyms.

Section BG

20. In contrast, the general anti-avoidance provision applies if the tax avoidance purpose or effect of an arrangement is not merely incidental: s YA 1 "tax avoidance arrangement" of the Income Tax Act 2007. The definition of "tax avoidance arrangement" states that there can be one or more purposes or effects of the arrangement. The tax avoidance purpose or effect does not need to be the only or dominant purpose or effect. Instead, the tax avoidance purpose or effect needs to be only more than merely incidental. A merely incidental tax avoidance purpose or effect is something which "naturally attaches or is subordinate or subsidiary to a concurrent legitimate purpose or effect, whether of a commercial or family nature": *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,834 (HC) at [206]. For a tax avoidance purpose to be merely incidental, it must be necessarily linked, without contrivance, to a non-tax purpose or effect. In that circumstance, the tax avoidance purpose or effect would be regarded objectively as a natural concomitant to the non-tax purpose or effect: *CIR v Challenge Corporation Ltd* (1986) 8 NZTC 5,001 (CA) at 5,005.

Difference between the two tests

21. The "more than merely incidental purpose" requirement for s BG 1, therefore, is fundamentally different from the "dominant purpose" requirement in s 141D. The "dominant purpose" test determines which is the most important or influential purpose. The "merely incidental" test determines whether the relevant purpose naturally attaches to some other purpose or effect.

Legislative intent was that penalty would only apply to abusive avoidance

22. Section 141D must be interpreted consistently with its immediate and general context: *Commerce Commission v Fonterra Co-Operative Group Ltd* [2007] NZSC 36 (SC). Relevantly, there is a graduated scale of penalties that apply to taxpayers who take tax positions that result in tax shortfalls. The shortfall penalties apply to tax positions that relate to tax avoidance arrangements and tax positions that breach other provisions. The range of possible penalties for tax avoidance arrangements is consistent with s 141D not applying automatically. In other words, another penalty (or no penalty) might apply to a tax position in respect of a tax avoidance arrangement.

23. The intention expressed in the pre-legislative material was that the abusive tax position penalty would only apply to "abusive avoidance". The penalty was not intended to apply to all tax avoidance arrangements. The abusive tax position penalty was introduced as part of the penalties regime in the Tax Administration Amendment Act (No 2) 1996. This amending Act had previously been part of the Taxpayer Compliance, Penalties, and Disputes Resolution Bill 1995. There were two discussion documents before the Bill. The first discussion document, *Taxpayer Compliance, Standards and Penalties* (Government discussion document, Legislative Affairs, Inland Revenue, August 1994), discussed the penalty as follows:

> 5.44 It will more clearly define the situations in which a penalty should be imposed. It will focus the penalty provisions on blatant and serious tax avoidance activity while recognising that not all tax avoidance necessarily merits a significant penalty.

24. The second discussion document, *Taxpayer Compliance, Standards and Penalties 2: Detailed proposals and draft legislation* (Government discussion document, Legislative Affairs, Inland Revenue, April 1995 (the Second Discussion Document), stated:

> 7.3 The earlier discussion document proposed a special penalty aimed at a narrow band of tax avoidance behaviour which was considered abusive. "Abusive avoidance" was considered to occur where arrangements had as their principal purpose the gaining of a tax advantage and the taxpayer's interpretation was not "more likely than not" to be correct. Such arrangements would be defined by characteristics such as artificiality, contrivance and lack of commerciality. They might also involve concealment of information.
>
> ...
>
> 7.8 If a taxpayer does not have a reasonably arguable position a second test will be applied to determine whether a tax position taken is "abusive". The second test is whether the dominant purpose of the arrangement was to avoid tax. The purpose will be determined by an objective consideration of the arrangement.
>
> ...
>
> 7.12 It is intended that the penalty for abusive arrangements apply not only in situations where a general or specific anti-avoidance provision is invoked, but also where other provisions have been applied. This recognises that the need to rely on an anti-avoidance provision does not necessarily indicate that the arrangement

> or tax position in question is inherently more deserving of a high penalty than are abusive interpretations of other provisions of the Acts.

25. The intention, therefore, was that the abusive tax position penalty would only apply to "abusive avoidance". In other words, the penalty was not intended to apply to all tax avoidance arrangements.

Courts have recognised the need for a dominant purpose of avoiding tax

26. There has been some uncertainty from various commentators about whether the approach adopted by the courts differs from the approach discussed above. Specifically, the various commentators have argued the approach adopted in *Ben Nevis* implies the abusive tax position penalty applies automatically if there is a tax avoidance arrangement.

27. *Ben Nevis* was called *Accent Management v CIR* in the High Court ((2005) 22 NZTC 19,027) and the Court of Appeal ([2007] NZCA 230, (2007) 23 NZTC 21,323). In the High Court, Venning J held the arrangement was a tax avoidance arrangement under s BG 1. However, Venning J held a tax avoidance arrangement was not a sufficient condition for the assessment of an abusive tax position penalty. Venning J emphasised the need for a dominant purpose of avoiding tax for an abusive tax position penalty to apply. On the facts, Venning J held the dominant purpose of the arrangement "was undoubtedly to achieve the taxation benefits of the arrangement" (at [370]). Venning J concluded, therefore, the abusive tax position penalty applied. On appeal, the Court of Appeal upheld the findings of the High Court.

28. Tipping, McGrath and Gault JJ delivered the majority judgment of the Supreme Court in *Ben Nevis*. The majority started by discussing the overall context of the penalty regime at [180]. This shows the majority considered it necessary to understand the context before looking at the specific requirements of the penalty. This in turn suggests the majority did not consider the penalty automatically applied because there was a tax avoidance arrangement.

29. The majority discussed the dominant purpose test as follows at [176]:

> … the tax position must be one that, viewed objectively, is taken by the taxpayer in respect, or as a consequence, of an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly. Alternatively, where there is no arrangement, the tax position itself must be taken by the taxpayer for that dominant purpose.

30. The majority then discussed the requirements of the purpose test at [205]–[208]. The discussion focused on whether it was the taxpayer's or the arrangement's purpose that needed to be considered. The Supreme Court concluded it was the purpose of the arrangement that was relevant under s 141D(7)(b)(i). The differences between the purpose requirement under the anti-avoidance provision and the abusive tax position penalty were not the issue. As noted above, the High Court and the Court of Appeal (in the decisions cited as *Accent Management*) concluded the Trinity scheme had the dominant purpose of avoiding tax. The fact the majority of the Supreme Court did not comment on this factual finding does not mean the court considered the issue to be answered by the existence of a tax avoidance arrangement.

31. Various other cases have applied the abusive tax position penalty. Several cases have not analysed the issue discussed above but have concluded that the penalty applied on the facts: *Alesco New Zealand Ltd v CIR* (2011) 25 NZTC ¶20-099 (HC), *Krukziener v CIR* (2010) 24 NZTC 24,563 (HC), *Case Z23* (2010) 24 NZTC 14,334, *Case Z19* (2009) 24 NZTC 14,217, *Case X25* (2006) 22 NZTC 12,303, *CIR v Campbell Investments* (2004) 21 NZTC 18,559 (HC) and *Erris Promotions Ltd v CIR* (2003) 21 NZTC 18,330 (HC). The cases have generally referred to the relevant dominant purpose. Judge Barber has more fully discussed s 141D in two Taxation Review Authority decisions: *Case Y18* (2008) 23 NZTC 13,180 and *Case Z1* (2009) 24 NZTC 14,001. In both cases Judge Barber emphasised the need for there to be a dominant purpose of avoiding tax for s 141D to apply. Judge Barber also noted the need for there to be a dominant purpose of avoiding tax for the penalty to apply in *Case 11/2011* (2011) 25 NZTC ¶1-011. In *Case 11/2011*, Judge Barber held the dominant purpose of the relevant arrangement was avoiding tax but there was not an unacceptable tax position.

32. It is considered the courts have recognised the need for a dominant purpose of avoiding tax for an abusive tax position penalty to apply. The courts have recognised that the abusive tax position penalty does not apply automatically if there is a tax avoidance arrangement.

Summary

33. In summary, the abusive tax position penalty under s 141D does not apply automatically where there is a "tax avoidance arrangement" under s BG 1. To determine whether the abusive tax position penalty applies it is necessary to decide whether the **dominant purpose** of the arrangement is avoiding tax.

What differentiates a case where s BG 1 applies but the penalty does not?

34. The second question this item answers is what differentiates a case where s BG 1 applies but the penalty does not. This part, therefore, describes how to determine when the abusive tax position penalty will apply where there is a tax avoidance arrangement under s BG 1.

Key difference

35. As determined above, there is a key difference between the circumstances where s BG 1 applies and those where the abusive tax position penalty applies. The difference is that the abusive tax position penalty only applies where the dominant purpose is avoiding tax. If there is an arrangement, the abusive tax position penalty only applies where the dominant purpose of the arrangement is avoiding tax. As noted above at [30], under s 141D(7)(b)(i) "purpose" does not mean the motives or intentions of the taxpayer: *Ben Nevis* at [207], *Erris Promotions* at [374].

36. To work out whether an arrangement has a dominant purpose of avoiding tax, the purposes of the arrangement will need to be identified and weighed. If the only purpose of the arrangement is avoiding tax then that will be the dominant purpose. If there are other purposes, these will need to be weighed against the purpose of avoiding tax to see which, if any, is dominant.

37. Purposes are identified and weighed in the context of the specific structure of the arrangement. As the test is to establish the dominant purpose of the arrangement, purposes will be relevant if they explain the specific structure of the arrangement. The fact that non-tax purposes may be able to be achieved by other structures does not in itself make them irrelevant. The point is: can the particular way the arrangement has been put together be explained by a non-tax purpose or purposes? If the specific features of the arrangement are mainly explicable by the tax purposes, then this would suggest that the dominant purpose is avoiding tax. If the specific features of the arrangement are mainly explicable by the non-tax purposes, then this would support the conclusion that the dominant purpose of the arrangement is not avoiding tax. If none of the purposes (tax or non-tax) are dominant, then the penalty will also not apply.

Factual indicators

38. A number of possible factual indicators are likely to be relevant in determining whether the dominant purpose of the arrangement is avoiding tax. The Second Discussion Document and *Taxpayer Compliance, Penalties, and Disputes Resolution Bill 1995: Commentary on the Bill* (Legislative Affairs, Inland Revenue, September 1995) listed artificiality, contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations of tax laws as relevant indicators. However, the indicators were not included in the legislation.

39. The listed factors may be the same factors that indicate there is a tax avoidance arrangement. However, the factors have to be considered again in the context of the different standard in the dominant purpose test in s 141D. In other words, it is necessary to consider whether the factors support the conclusion that the dominant purpose of the arrangement was avoiding tax.

40. The Second Discussion Document stated relevantly:

> 7.10 The draft legislation does not include a list of indicators of dominant purpose. Although such a list could highlight some of the factors to be considered in determining whether a penalty should be applied for abusive avoidance, rather than lack of a reasonably arguable position, the list could not be exhaustive, and the absence or inclusion of one factor might take on a significance which is unintended.

41. The reason the factors were not included in the legislation, therefore, was to prevent the absence of any factor having the unintended consequence of the penalty not applying. As discussed above, the test is whether the dominant purpose is avoiding tax. It is considered, therefore, that the absence of any of the factors will not indicate that the penalty does not apply. Further, the penalty may still apply if none of the listed factors are present. For example, there may be other factors (such as inflated values or a lack of economic substance) that may indicate that the dominant purpose of the arrangement is avoiding tax.

Cases

42. The cases have weighed the tax purposes of the relevant arrangements against the non-tax purposes: *Accent Management* (HC) at [370] (upheld in *Ben Nevis*), *Case Z23* at [125], *Krukziener* at [71]. The relevant cases have also looked at various indicators to help to determine if the dominant purpose of an arrangement is avoiding tax. For example, the courts have looked at the substance of the arrangement, the presence of artificiality and the extent to which the economic position of the person was altered by entry into the arrangement: Ronald Young J in *Erris Promotions* at [375]–[376], Wild J in *Campbell Investments Ltd* at [51] and Heath J in *Alesco* at [178]–[179].

43. The Commissioner has not imposed an abusive tax position penalty in respect of all tax avoidance arrangements. In all the cases where the penalty was at issue and the relevant arrangements were held to give rise to unacceptable tax positions, the courts found that each of the arrangements had a dominant purpose of avoiding tax. There are no cases, therefore, that have found that the tax avoidance purpose or effect of the arrangement was more than merely incidental under s BG 1 but the arrangement's purpose of avoiding tax was not dominant under s 141D. As a result, the courts have provided no guidance as to when a tax avoidance arrangement could be said to not have a dominant purpose of avoiding tax.

Summary

44. There is a key difference between the circumstances where s BG 1 applies and those where the penalty applies. Section BG 1 requires the tax avoidance purpose or effect of the arrangement to be more than merely incidental. In contrast, s 141D applies where there is a dominant purpose of avoiding tax. The key difference, therefore, is the requirement for the arrangement to have a dominant purpose of avoiding tax for s 141D to apply.

45. To determine whether the dominant purpose of the arrangement is avoiding tax, the tax purposes must be weighed against any non-tax purposes with reference to the specific structure used. The pre-legislative material suggests that indicators of a dominant purpose of avoiding tax may include artificiality, contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations of tax laws. The list is not exhaustive. These indicators were not specifically included in the legislation. However, the courts have held that the factors are relevant in helping to weigh the different purposes to determine whether the dominant purpose of an arrangement is avoiding tax. The factors are not independent indicators that the penalty applies.

References

Related rulings/statements
IS0055: Shortfall penalty – unacceptable interpretation and unacceptable tax position (*Tax Information Bulletin* Vol 17, No 9 (November 2005): 26)
IS0061: Shortfall penalty for taking an abusive tax position (*Tax Information Bulletin* Vol 18, No 1 (February 2006): 24)
Subject references
Avoiding tax; Dominant purpose
Legislative references
Section 141D of the Tax Administration Act 1994; Section BG 1 of the Income Tax Act 2007
Case references
Accent Management Ltd v CIR (2005) 22 NZTC 19,027 (HC)
Accent Management Ltd v CIR [2007] NZCA 230, (2007) 23 NZTC 21,323
Alesco New Zealand Ltd v CIR (2011) 25 NZTC ¶20-099 (HC)
Ashton & Anor v CIR (1975) 2 NZTC 61,030 (PC)
Ben Nevis Forestry Ventures Ltd v CIR [2008] NZSC 115, (2009) 24 NZTC 23,188
Case X25 (2006) 22 NZTC 12,303
Case Y18 (2008) 23 NZTC 13,180
Case Z1 (2009) 24 NZTC 14,001
Case Z19 (2009) 24 NZTC 14,217
Case Z23 (2010) 24 NZTC 14,334
Case 11/2011 (2011) 25 NZTC ¶1-011
CIR v Campbell Investments (2004) 21 NZTC 18,559 (HC)
CIR v Challenge Corporation Limited (1986) 8 NZTC 5,001 (CA)
CIR v National Distributors Ltd (1989) 11 NZTC 6,346 (CA)
Commerce Commission v Fonterra Co-Operative Group Ltd [2007] NZSC 36 (SC)
Erris Promotions Ltd v CIR (2003) 21 NZTC 18,330 (HC)
FCT v Spotless Services Limited & Anor 96 ATC 5,201
Glenharrow Holdings Ltd v CIR [2008] NZSC 116, (2009) 24 NZTC 23,236
Krukziener v CIR (2010) 24 NZTC 24,563
Newton v FC of T [1958] AC 450 (PC)
Westpac Banking Corporation v CIR (2009) 24 NZTC 23,834 (HC)
Other references
Taxpayer compliance, standards and penalties (Government discussion document, Legislative Affairs, Inland Revenue, August 1994)
Taxpayer compliance, standards and penalties 2: Detailed proposals and draft legislation (Government discussion document, Legislative Affairs, Inland Revenue, April 1995)
Taxpayer Compliance, Penalties, and Disputes Resolution Bill 1995: Commentary on the Bill (Legislative Affairs, Inland Revenue, September 1995)

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.

EXERCISE OF COURT DISCRETION TO LIQUIDATE INSOLVENT TRUSTEE COMPANY

Case	Commissioner of Inland Revenue v Newmarket Trustees Limited
Decision date	6 August 2012
Act(s)	Tax Administration Act 1994, Companies Act 1993, Trustee Act 1956
Keywords	Liquidation, insolvent trustee company, Court discretion

Summary

The Court of Appeal held that the Associate High Court Judge had exercised his discretion under section 241(4) of the Companies Act 1993 ("the Companies Act") on an erroneous basis. He overlooked the wider public interest considerations and well-established principles of trustee law, which meant that as a matter of principle, the respondent, as an insolvent trustee company, ought to have been put into liquidation.

Impact of decision

This is an important decision as it clarifies the responsibilities of corporate trustees and also clarifies the matters to be taken into account when considering whether an insolvent corporate trustee should be put into liquidation.

This decision will inevitably be of interest to law firms that provide trustee services to their clients under a similar legal structure.

Facts

Castle Brown (a law firm) established Newmarket Trustees Ltd ("Newmarket") to offer trustee services to its clients. It was a trustee of over 100 trusts. It did not have any beneficial interest in the trust assets nor did it own any other property.

Newmarket was a trustee of the Southern Lights Trust ("SLT") whose settlor, Mr Goh, was the other trustee of SLT and a client of Castle Brown.

The trustees of SLT had been default assessed for goods and services tax (GST) and income tax on assessable income derived from ten property transactions. Castle Brown was unaware of these assessments and they were not disputed. Mr Goh was adjudicated bankrupt in 2010.

The Commissioner of Inland Revenue (the Commissioner) took steps to obtain payment of the $293,251.23 owing. In November 2009 a statutory demand was served on Newmarket under section 289 of the Companies Act. An application by Newmarket to set aside the statutory demand was dismissed and an order was made requiring Newmarket to pay the debt within 20 working days (*Newmarket Trustees Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,176 (HC)).

The debt was not paid and the Commissioner applied under section 241 of the Companies Act for an order for the liquidation of Newmarket. The High Court stayed the proceeding with the stay to be rescinded on the Commissioner meeting Newmarket's costs (*Commissioner of Inland Revenue v Newmarket Trustees Ltd* (2010) 24 NZTC 24,397 (HC)).

Following payment of the costs by the Commissioner, the application proceeded as a hearing of the liquidation application on the merits rather than as a stay application. Associate Judge Bell dismissed the Commissioner's application for the liquidation of Newmarket (*Commissioner of Inland Revenue v Newmarket Trustees Ltd* (2011) 25 NZTC 20-030 (HC)). This decision was appealed by the Commissioner.

Decision

The Commissioner in the appeal submitted that the High Court erred in:

1. finding that the default assessments were potentially open to amendment and correction under section

113 of the Tax Administration Act 1994 contrary to the decision of the Supreme Court in *Tannadyce v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153;

2. failing to take into account that Newmarket, as co-trustee of SLT, was jointly and severally liable for SLT's unpaid tax liability and not entitled to delegate payment of its tax liabilities to its co-trustee, Mr Goh;
3. taking into account the costs of making alternative arrangements for other trusts of which Newmarket was trustee; and
4. failing to recognise that wider public interest considerations of deterrence and removal of risk for Castle Brown's other trusts, as well as principles of trustee law, meant that Newmarket, as an insolvent trustee company, should be put into liquidation.

Newmarket submitted that the Associate Judge had correctly exercised the Court's unfettered discretion and that the Associate Judge had appropriately distinguished *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA). Newmarket further submitted that the Associate Judge had not erred because:

1. he accepted that the underlying tax debt was indisputable for the purpose of the liquidation proceeding;
2. he correctly accepted that Newmarket was jointly and severally liable for the tax debts of SLT as this was the basis of his finding that a prima facie case had been made out; and
3. he was entitled to take into account the impact that liquidation would have on the other trusts for which Newmarket acted as trustee. It was appropriate for the Court to have regard to the substantial work required and costs incurred in organising a replacement trustee.

The Court of Appeal accepted that the default assessments could not be challenged by Newmarket in this proceeding. However, this was not accepted as being a ground for overturning the decision of the High Court. The Court stated that there was an error of law, but noted that this was not a significant point in the High Court decision.

The Court of Appeal accepted Newmarket's submission that the Associate Judge correctly accepted that Newmarket was jointly and severally liable for the tax debts of SLT. This was the basis of his finding that a prima facie case had been made out.

The Court of Appeal further stated that Newmarket was not entitled to delegate payment of its tax liabilities to its co-trustee, Mr Goh. The Court noted the general rule that trustees may not delegate their duties or powers. This general rule against delegation extends to a prohibition on delegation to a co-trustee. The fundamental breaches by Newmarket of its trustee responsibilities and its failure to meet its tax liability, which led to its insolvency, ought to have been taken into account by the Associate Judge and he did not do so when he declined to exercise the Court's ultimate discretion.

The Court of Appeal noted that while it was not wrong for the Associate Judge to refer to the cost of making alternative arrangements, it overlooked the key point being that the end result was that Castle Brown's other trusts would be left with an insolvent trustee. The general policy of the Companies Act is that insolvent companies should be liquidated and there must be a good reason why in a particular case the insolvent company should not be put into liquidation.

The Court held that it was not satisfied that there was any sufficiently compelling ground of principle or justice to overcome the general policy of the Companies Act with regard to insolvent companies. However, the Court found there were good reasons why Newmarket should be put into liquidation, these being that:

1. trusts should be properly administered and an insolvent trustee company is unfit to be a trustee; and
2. the principles of trustee law, reflected in section 51(2) of the Trustee Act 1956, are that an insolvent trustee company should, as a general rule, almost invariably be put into liquidation. This would enable the Court to ensure that the trust is properly administered either by the liquidator or a replacement trustee.

The Court ultimately held the Associate Judge had wrongly exercised the discretion under section 241(4) of the Companies Act. He had overlooked the wider public interest considerations and well-established principles of trustee law, which meant, as a matter of principle, Newmarket as an insolvent trustee company ought to have been put into liquidation.

The Court of Appeal remitted that application for the appointment of a liquidator back to the High Court to make an appointment under section 241(4)(a) of the Companies Act.

CONSIDERATION OF THE "EVIDENCE EXCLUSION" RULE

Case	Te Akau Stallion Syndicate No 1 v Commissioner of Inland Revenue
Decision date	13 August 2012
Act(s)	Tax Administration Act 1994
Keywords	Strike out, evidence exclusion

Summary

The taxpayer sought to strike out certain pleadings in the Commissioner of Inland Revenue's ("the Commissioner") Statement of Defence. The Commissioner successfully opposed the strike-out application primarily relying on the "evidence exclusion" rule in section 138G of the Tax Administration Act 1994 ("TAA").

Impact of decision

The judgment considers the requirement of no arguable defence to succeed in a strike out application and provides some guidance on the application of section 138G of the TAA. It reinforces the legislative requirement for both parties to refer to all issues and propositions of law in a Statement of Position to be raised in a challenge. (This case was dealt with under the old evidence exclusion rule which was replaced by the Tax Administration and Remedial Matters Act 2011 effective 29 August 2011.)

Facts

The Te Akau Stallion Syndicate No 1 ("the Syndicate") was formed in 2008. It purchased a thoroughbred colt at the 2008 Karaka sale for $550,000.

In the tax years 2008 and 2009, each member of the syndicate claimed a deduction for their respective share of the syndicate loss which was made up of expenditure incurred in relation to the colt and a 75% diminishing value write down of the purchase price.

The Commissioner allowed deductions for expenses incurred in relation to the colt. However, deductions for the cost of the colt were denied on the basis the syndicate was not in the business of breeding bloodstock pursuant to section EC39(1) of the Income Tax Act 2007.

Five syndicate members (the plaintiffs) challenged the Commissioner's finding in relation to the deduction for the cost of the colt. Included in the plaintiffs' Statement of Claim was an allegation that the fourth plaintiff was in the business of breeding outside the syndicate and was therefore entitled to its share of the value of the colt.

The Commissioner considered section 138G of the TAA applied to prevent the plaintiffs raising those three allegations in the challenge that had been referred to in the plaintiffs' Statement of Position and therefore denied he was required to plead to them in his Statement of Defence.

Decision

Associate Judge Faire began by setting out the general principles of strike out as per *Attorney General v Prince and Gardener* [1998] 1 NZLR 262 (CA). The issue to be determined here was whether there was no reasonably arguable defence that the plaintiffs were estopped from pleading due to section 138G of the TAA.

He also set out the requirements of "due diligence" pursuant to section 138G(2)(a) and "manifest injustice" pursuant to section 138G(2)(b) of the TAA to succeed on the application for leave to raise the matters set out in paragraphs 35, 21, 22 and 25 of the Statement of Claim.

In terms of the allegations concerning the fourth plaintiff, the Judge considered the Commissioner's pleading advanced was a reasonably arguable defence to the allegation made in the Statement of Claim. In addition, there was evidence in support of the contention made in the defence.

It was clear the pleading in the Statement of Defence had foundation to it and there was no justification for striking out the paragraph.

In terms of section 138G of the TAA, the plaintiffs had provided no evidence that they could not have with due diligence discovered the facts and issues referred to. The Judge was not satisfied a case had been made out that would justify the granting of leave.

The Statement of Claim contained allegations in relation to the deductions allowed by Inland Revenue's Adjudication Unit for expenses incurred by the syndicate in relation to the colt. While it was apparent the factual matters referred to in those paragraphs were in the plaintiffs' Statement of Position, there was no reference to inconsistency of the treatment of the two types of deductions claimed.

In terms of the strike-out, the Judge considered there was a reasonably arguable defence of estoppel and therefore could not strike out the pleadings in the Statement of Defence.

In relation to the section 138G of the TAA application, the Judge agreed with the Commissioner that while section 138G(2)(a) of the TAA was satisfied for these paragraphs, there was no manifest injustice in not granting leave as the correctness of the assessment did not turn on the correction of another assessment.

The Statement of Claim contained allegations in relation to the GST dispute. The Commissioner submitted that section 138G of the TAA did not permit the plaintiffs to refer to the GST dispute, particularly in relation to the issue of inconsistency which had not been raised in the Statement

of Position. In addition, the Commissioner submitted that an inconsistency argument was not a ground for challenging an assessment and referred to a number of sections in the TAA that allowed the Commissioner to change his assessment.

On the basis of these arguments, the Judge considered that it was not appropriate to strike out the pleadings in the Commissioner's Statement of Defence.

The Judge again agreed with the Commissioner that there would be no manifest injustice in not allowing leave pursuant to section 138G(2)(b) of the TAA as the inconsistency argument was irrelevant to the determination of the issues.

THE SUPREME COURT DISMISSES MR RUSSELL'S APPLICATION FOR LEAVE TO APPEAL

Case	John George Russell v Commissioner of Inland Revenue
Decision date	13 August 2012
Act(s)	Income Tax Act 1976
Keywords	Tax avoidance, public importance, substantial miscarriage of justice, interests of justice

Summary

The Supreme Court has dismissed Mr Russell's application for leave to appeal the decision of the Court of Appeal.

Facts

Mr Russell applied to the Supreme Court for leave to appeal the decision of the Court of Appeal which rejected his objection to a tax assessment of his income (*Russell v Commissioner of Inland Revenue* [2012] NZCA 128).

The substance of the case related to the CM Partnership and activities conducted by two of Mr Russell's companies between 1985 and 2000. These activities were found to constitute an arrangement having the purpose and effect of tax avoidance by which Mr Russell was affected and by which he obtained tax benefits.

Decision

The Supreme Court dismissed Mr Russell's application on the grounds that the statutory criteria for appeal were not made out. Accordingly, the Supreme Court considered the following:

1. The decision of the Court of Appeal represented the application of well-settled legal principles to the particular facts of the case.
2. The Court of Appeal upheld the findings in the High Court and Taxation Review Authority that:
   i) there was an arrangement;
   ii) its purpose or effect was to alter the incidence of tax;
   iii) Mr Russell was affected; and
   iv) the tax avoidance involved was more than merely incidental.
3. Mr Russell had failed to show, in any of the Courts, that the Commissioner's reconstruction was wrong, let alone by how much.
4. Mr Russell's application regarding the effect of section 99(4) of the Income Tax Act 1976, as advanced in the Court of Appeal, had no merit.
5. None of the matters which Mr Russell sought to raise by further appeal were of general or public importance. Nor was there any basis for concern that a substantial miscarriage of justice might occur if leave was not given.
6. Granting leave would not be in the interests of justice as none of the points Mr Russell sought to raise were reasonably arguable in his favour. The Court of Appeal was undoubtedly correct in the conclusions to which it came on the facts of this case. Save for some inconsequential minor matters, those facts were the subject of agreement in the Court of Appeal.

The Supreme Court ordered costs to the Commissioner of $5,000 plus all reasonable disbursements.

COSTS REDUCED DUE TO ARITHMETICAL ERROR

Case	Chesterfields Preschools Limited & Others v Commissioner of Inland Revenue
Decision date	30 August 2012
Act(s)	High Court Rules
Keywords	Costs awarded, arithmetical errors, disbursements

Summary

On 29 June 2012, the High Court ordered a total of $261,089.20 in costs to the plaintiffs and reserved leave for applications for additional disbursements, to correct arithmetical mistakes or to pursue arguments on the case management conference costs. The Commissioner applied to the Court to correct arithmetical mistakes in the judgment.

Impact of decision

The costs awarded to the plaintiffs were reduced by $31,200.

Facts

The Commissioner argued that there were arithmetical errors in the judgment of 29 June 2012, which resulted in an extra 19.5 days ($31,200) being awarded to the plaintiffs.

Mr Hampton for the plaintiffs argued that the Commissioner ignored the schedule of disbursements he had provided. The plaintiffs claimed $62,597.92 less undisputed disbursements of $41,969, leaving a balance of $20,628.72 disbursements in dispute.

Mr Hampton also argued that case management conference attendances should also be included. The Commissioner argued that the attendances (various minutes and memoranda) do not justify any further costs award.

Decision

Justice Fogarty accepted that there had been an arithmetical error in his judgment of 29 June 2012. Judgment was entered in favour of the plaintiffs against the Commissioner in the sum of $229,889.20. Leave was reserved for further submissions on the plaintiffs' claim for additional disbursements. Leave was also reserved for further submissions on case management conference attendances. Costs are reserved.

CONDUCTING A TAXABLE ACTIVITY

Case	A Taxpayer v Commissioner of Inland Revenue
Decision date	28 August 2012
Act(s)	Goods and Services Tax Act 1985
Keywords	Conducting a taxable activity, continuous and regular

Summary

The Commissioner determined that the taxpayer was not conducting a taxable activity, because the activity undertaken in relation to the disputant's property was insufficient to constitute a taxable activity in itself, and there was insufficient evidence of any activity in relation to the disputant's asserted intent to undertake further developments. The Commissioner therefore considered that the disputant should have its goods and services tax (GST) registration cancelled pursuant to sections 52(5) and 52(5A) of the Goods and Services Tax Act 1985. The disputant challenged the Commissioner's decision by filing challenge proceedings in the Taxation Review Authority ("TRA").

Impact of decision

This case reaffirms the standard position in *Newman v CIR* [1994] NZCA 150, NZTC 1 12097 about the need for a taxpayer to show that the activity in question was both continuous and regular and as such does not have any binding implications. This case is very fact-specific.

Facts

In June 2007, the disputant purchased a residential property in St Heliers, Auckland, ("the property") for $8.7 million (including GST). It claimed the purchase price of the property as an input credit for GST purposes on the basis that it was conducting a taxable activity involving the purchase, subdivision, refurbishment and sale of high-end residential properties.

The disputant says it intended to subdivide and resell the property, as the first of a number of property projects. The property was duly listed for sale nine days after purchase, subject to the proposed subdivision. At this point, approximately $40,000 had been spent on repairs and maintenance. The property was eventually resold, undivided and undeveloped, back to the original vendor (and second mortgagee) in August 2008. The disputant paid GST output tax on the sale back to the vendor, which resulted in a net GST position of $60,000 in favour of the disputant. The disputant has undertaken no further activity.

The Commissioner determined that the disputant was not conducting a taxable activity, because the activity undertaken in relation to the property was insufficient to constitute a taxable activity in itself, and there was insufficient evidence of any activity in relation to the disputant's asserted intent to undertake further developments.

The Commissioner declined the disputant's claim for a GST input credit and deregistered it for GST. The disputant challenged those decisions.

Decision

The evidence for the disputant was given solely by Mr K who was listed as a general manager but for many years had been an experienced property developer. The TRA noted that he was closely associated with the disputant and another trust which acted as a development manager for the disputant as well as being the husband of the sole shareholder and director of the corporate trustee of the disputant.

A summary of the submissions made by the disputant in relation to why it had conducted a taxable activity on a continuous basis is given at [61].

The Commissioner argued that the disputant's activities did not constitute "continuous or regular" activities and therefore could not constitute a "taxable activity" for GST purposes.

The TRA made a finding at [96] that Mr K was a credible and honest witness and that the disputant had purchased a substantial property for three prime reasons, namely: first, to sever part of it and sell that part to its associated trust; second, to substantially upgrade the house on the remainder of the property and sell it; and, third, to reinvest those funds with profits into a similar project and so on indefinitely.

The TRA did not regard the activity in selecting the property and purchasing it (which included financing arrangements) as merely preparatory steps to commencing a taxable activity. The TRA also noted that there were some substantial survey and subdivision costs and evidence of significant expenditure in upgrading the property, and the further activity of marketing it. Further, the TRA found that the activity was "continuous" and it was intended to be "regular" but did not get to that as events unfolded.

The TRA did not accept the Commissioner's contention that the venture was never financially viable and found that the venture failed through lack of capital and a deteriorating property market.

For these reasons, the TRA found that at all material times, until the sale of the property at issue, the disputant was carrying on the taxable activity of a property developer and needed to be registered for GST and was entitled to the said GST input.

NO TAXABLE ACTIVITY

Case	Taxpayer Ltd (in receivership) v Commissioner of Inland Revenue [2012] NZTRA 05
Decision date	10 August 2012
Act(s)	Goods and Services Tax Act 1985
Keywords	Taxable activity, objection, deregistration

Summary

The taxpayer objected to its input credit claims being disallowed and being deregistered for goods and services tax (GST). The taxpayer did not prove it had a taxable activity and its other grounds of objection (sham, onus on the Commissioner, bad faith and malicious harassment) were all rejected.

Impact of decision

This finalises an objection first made in August 1996.

Facts

This proceeding originally involved two tax types: income tax and GST. The income tax issue was resolved in favour of Taxpayer Ltd ("the objector") thus leaving the GST issues to be determined.

On 1 October 1986, the objector registered for GST on a two-monthly return basis. Later, it changed to a six-monthly basis for periods ending 31 January and 31 July and described its taxable activity as unlicensed moteliers. On 20 February 1987, the objector was placed into receivership.

By October 1995, the objector was the principal in an agency and management agreement within a group of companies. The related agent was a fuel transporting company, F Limited.

In August 1996, the Commissioner reassessed the objector's GST returns (disallowing input tax credit claims) for the periods ended 31 July 1992 to 31 January 1996 inclusive and deregistered.

Decision

Did the objector supply sufficient evidence in support of its GST registration?

To qualify for opting to register for GST, the objector must carry on a "taxable activity" or intend to do so from a specific date (section 51(3) of the Goods and Services Tax Act 1985).

Evidence was given on behalf of the Commissioner at the hearing that the objector failed to show that it was carrying on a taxable activity. It was also noted that the objector stopped accounting for sales in 1990 and from then onwards the objector usually had large losses due to interest costs.

The receiver submitted that he was the receiver of the objector and was authorised to give evidence on its behalf. He argued that a taxable activity effectively continues to the end of a receivership. He submitted that as the receiver's costs are incurred in respect of the past taxable activity and the closing down thereof, such receiver's costs are a legitimate claim in respect of the period in which they are incurred.

When asked what the taxable activity of the objector was from October 1988, the receiver's response seemed to be that the objector's inputs were used by F Limited, which had become the principal with the objector as its agent. Accordingly, the objector's activity was purportedly hauling fuel.

Judge Barber found this to be inconsistent with the financial accounts for F Limited, which showed that in 1994 it had ceased receiving any cartage receipts or income. Further, his Honour found that:

a) the chattels necessary to conduct the taxable activity, which the receiver purports to be continuing, were sold in 1989;

b) there was an apparent and unexplained lack of sales after 1990, which lines up with the actual cessation of the taxable activity;

c) no consulting fees to substantiate the objector's submission that an agency and a management agreement existed (between the objector and F Limited) prior to 1994; and

d) there was no income from any business activities potentially capable of being a taxable activity until 1995.

The receiver's evidence showed that the inputs accounted for by the objector related solely to receivership costs and that the objector had to borrow money to meet those costs.

His Honour held that the taxable activity concluded in 1990 at the latest. He rejected the argument that a taxable activity can be assumed to exist from the mere fact of receivership and held that a taxable activity must still be conducted. The receiver may have entered into a new taxable activity in 1994 (although it is not clear) but any such new taxable activity cannot be part of the cessation of an earlier one.

Did the objector justify the failure to account for any output tax during the period it was registered for GST?

The receiver submitted that output taxes payable by the objector were returned by F Limited as the objector's agent.

Evidence for the Commissioner emphasised that it was unusual for a single GST activity to be split so that one taxpayer accounts for the output and another for the input tax.

Judge Barber found that the objector had not returned any GST outputs since the date of registration and had only accounted for input credits creating refunds to it.

Other grounds of objection

The objector invoked a number of non-tax-specific grounds of objection:

a) Sham must underlie the GST assessments and accordingly it formed a basis of objection.

b) There is a threshold onus on the Commissioner to show any assessments are not manifestly arbitrary, or demonstrably unfair.

c) The assessments are motivated by bad faith for the ulterior motive of destroying the receiver's business and that this is an illegal and proper purpose.

d) The objector has suffered unfair and questionable conduct by the Commissioner as part of malicious harassment of the receiver.

Judge Barber rejected these grounds of objection and found that none of the contentions made by the objector were supported by evidence to establish its position on the balance of probabilities. Accordingly the objection was dismissed and the GST deregistration and reassessments (bar one due to time bar) were confirmed.

Judge Barber specifically noted that he imported into this decision the reasoning in [2012] NZTRA 04 issued on the same day, *mutatis mutandis*.

NO TAXABLE ACTIVITY

Case	Taxpayer Ltd (in receivership) v Commissioner of Inland Revenue [2012] NZTRA 04
Decision date	10 August 2012
Act(s)	Goods and Services Tax Act 1985
Keywords	Taxable activity, objection, deregistration

Summary

The taxpayer objected to its input credit claims being disallowed and being deregistered for goods and services tax (GST). The taxpayer did not prove it had a taxable activity and its other grounds of objection (sham, onus on the Commissioner, bad faith and malicious harassment) were all rejected.

Impact of decision

This finalises an objection first made in August 1996.

Facts

This proceeding originally involved two tax types, income tax and GST. The income tax issue was resolved in favour of Taxpayer Limited ("the objector") thus leaving the GST issues to be determined.

This case is very similar to the [2012] NZTRA 05 decision with the slight variation that the objector in this case is not in receivership and did not enter into the arrangement involving an agency and management agreement. The judgments were issued on the same day, *mutatis mutandis*. The evidence of the parties and Judge Barber's reasoning were imported from the other case.

The objector was incorporated on 29 June 1992 and was registered for GST on 11 June 1992 on a six-monthly return

basis and on a payment basis. It described its taxable activity as "financial asset broking service" and remains registered on the New Zealand Companies Office Register. It is neither in receivership nor liquidation.

In August 1996, the objector was reassessed for the GST periods ended 31 March 1993 to 31 March 1996 inclusive and was deregistered.

Decision

Did the objector supply sufficient evidence in support of its GST registration?

To qualify for opting to register for GST, the objector must carry on a "taxable activity" or intend to do so from a specific date (section 51(3) of the Goods and Services Tax Act 1985).

It was submitted by the objector's representative that the objector had a taxable activity in respect of transactions which involved trading in shares and securities and was also involved in transactions which earned fees for financial services and interest.

Evidence was given on behalf of the Commissioner at the hearing that the objector failed to show that it was carrying on a taxable activity. In particular, it was noted that there was correspondence between the objector's tax agent and the Commissioner requesting records (particularly in relation to the 31 March 1996 return period) but no documents or other evidence were supplied to demonstrate that the GST registration of the objector was correct and should be maintained.

Judge Barber found that the objector failed to return any taxable supplies for four years and agreed with the Commissioner that the objector provided no evidence to support its contention that its financial asset broking service is a GST taxable activity.

Did the objector justify the failure to account for any output tax during the period it was registered for GST?

The objector's representative submitted that the reason why the objector did not return output taxes was because:

> … there had been no transactions so far that carried out an output tax liability. However there is a possibility that there will be transactions from time to time that will carry an output tax liability and if and when such occurs then output tax will become payable.

Furthermore, the objector's representative explained that the GST transactions were, in a sense, transactions between various group entities and that, effectively, there would be no loss to the revenue because another group entity returned the output tax while the present objector claimed the inputs. He regarded the overall effect as neutral.

A witness for the Commissioner emphasised the correspondence between the Commissioner and the objector's tax agent, in particular the letter issued on 24 July 1996, which outlined that the objector had returned no outputs since registration in 1992 and that if no substantive evidence or information was provided within 10 days, the Commissioner would cancel the objector's registration and seek to recover input tax refunds paid to the objector.

The objector's representative did not dispute this point, but rather complained (via a letter dated 8 August 1996) of the time frame to provide the requested information and raised questions regarding the Commissioner's actions.

No documents or other evidence were supplied by the objector to demonstrate that the GST registration of the objector was correct and should be maintained.

On the evidence available, Judge Barber found that, over material times, the objector failed to account for output tax and that it was unclear as to what transactions the claimed inputs related to.

Other grounds of objection

Judge Barber found that the Track C objection by the objector's representative was not sustainable because it was not part of the original objection and in any event it was irrelevant because it was not applied by the Commissioner to the GST.

The objector also invoked a number of non-tax-specific grounds of objection:

a) There is a threshold onus on the Commissioner to show any assessments are not manifestly arbitrary, or demonstrably unfair.

b) The assessments were motivated by bad faith for the ulterior motive of destroying the business of the objector's tax agent and that this is an illegal and proper purpose.

c) The objector suffered unfair and questionable conduct by the Commissioner as part of malicious harassment of the objector's tax agent.

d) The Commissioner cannot backdate deregistration.

e) The objector's GST registration was investigated earlier and cannot be revisited.

f) The time bar applies.

Judge Barber rejected these grounds of objection, found that none of the contentions made by the objector were supported by evidence to establish its position and such evidence as is available supports the Commissioner. Judge Barber also found that the other grounds of objection are ill founded and inapplicable.

Accordingly the objection was dismissed and the GST deregistration and reassessments were confirmed.

SECTION 16 – COMMISSIONER'S POWERS TO OBTAIN INFORMATION

Case	Tauber & Others v Commissioner of Inland Revenue
Decision date	7 September 2012
Act(s)	Tax Administration Act 1994
Keywords	Section 16, Commissioner's powers, search and seizure, access warrant, business premises, private dwelling, reasonableness, remove and retain documents

Summary

This was an appeal of a High Court decision which dismissed a judicial review application by the appellants, challenging the issuance and execution of section 16 warrants and seeking orders for the Commissioner to not inspect and return the documents seized. The Court of Appeal upheld the High Court decision and found the Commissioner's application for the access warrants for private dwellings and removal and retention of documents lawful and reasonable.

Impact of decision

The decision vindicates the procedures followed by the Commissioner's access and removal teams and shows they were methodical, justifiable and not unreasonable.

The decision also confirms the precedent set by the *Avowal* litigation:

- the statutory form of warrant is sufficient;
- the Commissioner need not exhaust alternative investigatory powers before relying on section 16 of the Tax Administration Act 1994 ("TAA");
- other persons may accompany the officer executing the warrants so long as their presence is necessary for the effective exercise of the search and inspection powers.

Facts

This is an appeal of the High Court decision of Venning J in favour of the Commissioner of Inland Revenue ("the Commissioner") dismissing the appellant's judicial review application.

As part of her investigation into Messrs Tauber and Webb as well as associated entities, the Commissioner applied to the District Court for warrants pursuant to sections 16(4) and 16C(2) of the TAA. Warrants were issued to enter four private dwellings alongside eight warrants issued to remove and retain documents accessed from the private dwellings and four businesses under section 16. This included the registered address (as well as the home address) of Ms Bockett, the accountant of the Honk Entities.

On 16 March 2011, the Commissioner executed the warrants. A total of eight sites were accessed: six in Auckland and two in Hamilton.

A total of 111 boxes of hard copy books and documents were removed, along with approximately 9.5 terabytes of electronic media from the Auckland sites. Late on 16 March 2011, a blanket privilege claim was made over all hard copy and electronic information removed.

On 8 April 2011, the applicants filed their judicial review application challenging the lawfulness and reasonableness of the access and removal operations for the six Auckland sites.

Following the hearing in the High Court, the appellants failed to make out any grounds for review. They have appealed aspects of that decision.

Decision

All challenges to the warrants failed. The appeal was dismissed and the Commissioner was awarded one set of costs from all the appellants.

Appropriateness of judicial review

The Court found that the facts fell into the recognised exception in the case of *Gill v Attorney-General* [2010] NZCA 468, [2011] 1 NZLR 433 and therefore judicial review was appropriate. *Gill* states that a judicial review of a search warrant is generally not appropriate because the most suitable remedy for any errors in the process is the exclusion of wrongly seized evidence. However, because the nature and the scope of these warrants impacted directly both on the powers of the Commissioner and whether these powers have been lawfully exercised, the review was appropriate.

Consideration of the unredacted affidavit

In the High Court, the case had proceeded on the basis that access to the unredacted affidavit was not required. Venning J reserved his position on this point and indicated that he would call for an unredacted copy if required. In the Court of Appeal, the Judges questioned whether it would be possible to review the decision of the District Court without seeing all material provided to them. A copy of the unredacted application was given to them.

The Judges reviewed the application to ensure that no material had been unduly redacted. While a few small portions were questionably masked, they did not consider that material relevant to the issues on appeal. They were satisfied that it was proper for them to have access to, and review, the full unredacted application.

Was the Commissioner's reliance on section 16 powers reasonable?

This issue focused on whether the warrants were required for the Commissioner to exercise her functions. The Court agreed with Baragwanath J in *Avowal Administrative Attorneys Lt v District Court at North Shore* [2010] 2 NZLR 794 and found the following:

1. A warrant issued under section 16(4) is not a warrant to search the premises for particular information or documents but rather gives access to enter a private dwelling. The Commissioner's power to inspect documents on these premises then comes from part of the broader statutory power, section 16(1).
2. Section 21 of the Bill of Rights Act 1990 (the freedom from unreasonable search and seizure) requires that section 16(4) is to be read subject to an overall test of reasonableness in all the circumstances.
3. Whether or not other options have been pursued is one of the factors to be taken into account when determining whether a warrant should be issued. However, there should be no absolute requirement that the Commissioner should exhaust all options before seeking a warrant.
4. The Commissioner's power under section 16C to seize and retain documents for inspection is more intrusive than taking copies under section 16B. Therefore, the judicial officer considering the warrant application must be satisfied in all the circumstances that there are reasonable grounds for believing that the Commissioner may require removing documents to exercise her functions.

Alleged errors and omissions in affidavit

The Court agreed with the High Court judge. The errors or failing contained in the affidavit were primarily in relation to emphasis and in the context of a lengthy affidavit, they were not material. Even if restricted to considering the redacted affidavit, none of the challenges would succeed.

The form of the warrants

The appellant contended that the warrants did not meet the requirements of section 16(5)(b). Section 16(5)(b) requires that the warrant issued specify a class of persons who may have physical access to a private dwelling under a warrant issued under s 16(4). The Court stated that a class of every officer authorised by the Commissioner met this requirement.

Counsel for the appellants argued that the warrants were drawn too widely and did not have as much specificity as the circumstances allowed. The Court upheld *Avowal*; because these warrants were issued under the statutory scheme of a civil tax-recovery scheme they were not analogous to search warrants under the criminal law or other legislation. The Commissioner's powers under section 16 are necessarily broad given the complexity that is often inherent in tax investigations. Therefore, the warrants were not expressed too broadly.

Were the warrants reasonably required?

The Court gave separate consideration to the applications for the access warrants to the private homes of Messrs Tauber and Webb, as opposed to that of Ms Bockett out of deference to her status as a professional.

The access warrants for the private dwellings of Messrs Tauber and Webb, as well as the related removal and retention warrants, were lawful and reasonable. The affidavit demonstrated that it was reasonable in all circumstances of the case for the Commissioner to seek the access warrants on the basis that the warrants were reasonably required. It was not necessary for the Commissioner to demonstrate that all other options available to her under the TAA had been exhausted.

The Court was satisfied by a narrow margin that the affidavit filed in support of the warrants for the private dwelling of Ms Bockett demonstrated that it was reasonable in all the circumstances of the case for the Commissioner to seek the warrants. Particular emphasis was placed on evidence pointing towards a pattern of action on behalf of Honk Entities and others that obstructed the Commissioner's investigation. This included a failure by Honk Entities, which Ms Bockett was agent of, to comply with section 17 requests.

Had the Court found that the warrants in respect of Ms Bockett's residence were unlawful it would have been necessary to consider the question of remedy. The Judges determined that even if they had determined that the warrants were unlawful, the breach could only have been classified as slight and therefore no relief would have been granted.

TAX AVOIDANCE – FRAUD ON A PERSON AFFECTED BY THE ARRANGEMENT

Case	TRA 011/10
Decision date	11 September 2012
Act(s)	Income Tax Act 1994, Income Tax Act 2004
Keywords	Tax avoidance, fraud, party to the arrangement, meeting of the minds, person affected by the arrangement

Summary

The Commissioner is not required to satisfy herself that the taxpayer is fully aware of all aspects of an arrangement or that the taxpayer has not been the victim of fraud by a third party in relation to an arrangement to apply the general anti-avoidance rule.

Facts

In the income tax years ended 31 March 2004 to 31 March 2006, the disputant participated in an arrangement which purported to constitute an employee indemnity fund ("the EIF") for the benefit of the disputant's employees.

Ultimately, the disputant claimed deductions in the relevant income years for contributions, fees, insurance and interest paid under the EIF. The Commissioner reversed the deductions and assessed the disputant for shortfall penalties.

The parties to this matter agreed to have a preliminary question of law heard by the Taxation Review Authority ("TRA") before proceeding to a hearing on the substantive issues in dispute:

> Even if there was a fraud on the disputant in relation to any arrangement, either wholly or in part, does that preclude sections OB 1, BG 1 and GB 1 of the Income Tax Act 1994 or the Income Tax Act 2004 from applying to the arrangement?

Decision

The disputant asserted that the EIF was fraudulent and as a consequence the contributions paid by the disputant (by way of loan) to the relevant fund never existed. Accordingly, as the transactions were not genuine, the contribution payments could trigger no deductions (albeit the disputant maintained it was still entitled to deductions for payments made relating to insurance, interest and fees on the basis of fraud or misappropriation pursuant to section DJ 8 of the Income Tax Act 2004). The disputant asserted that where there is such a fraud there can be no tax avoidance.

Fraud

The TRA confirmed that there is no general crime of fraud in the common law albeit it has a clear meaning in criminal law of "dishonesty" (noting that to some extent it overlaps with the meaning of fraud in civil law and equity). For the purposes of this dispute, the TRA confirmed that "fraud" is taken to encompass any conduct as a result of which the disputant has not given informed consent as to the true nature of the scheme in which it participated (which the TRA considered would include being the victim of either civil or equitable fraud).

Further, the disputant had asserted that where there is evidence of fraud, the TRA was required to look behind the arrangements and analyse the substance or the real legal relationship to determine the basis upon which the disputant should be taxed. The disputant relied on the decisions of *Calkin v Commissioner of Inland Revenue* [1984] 1 NZLR 440 and *R v Connolly* (2004) 21 NZTC 18,844. The Commissioner rejected these arguments and the TRA agreed with the Commissioner. In particular, the TRA pointed out that Court in *Calkin* did not consider whether fraud nullifies a transaction for tax purposes and the issue in *Connolly* was sham (and sham is not an issue in the current dispute).

Avoidance

After setting out the leading case law on the general anti-avoidance rule, the TRA confirmed that it was clear from the Agreed Statement of Facts that there was a plan or understanding between the disputant and the participants/promoters of the EIF.

Further, as a matter of statutory interpretation, the combined effect of section BG 1 and the definitions of "arrangement" and "tax avoidance arrangement" means that even if a taxpayer is the victim of fraud, a tax avoidance arrangement can still exist.

The TRA confirmed that the intention of the parties in entering the arrangement is irrelevant and an arrangement does not require consensus or a meeting of the minds (referring to *Russell v Commissioner of Inland Revenue* [2012] NZCA 128, (2012) 25 NZTC 20,120, *Peterson v Commissioner of Inland Revenue* [2005] UKPC 5, [2006] NZLR 433 and the dissenting judgment of Thomas J in *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450). Accordingly, the TRA concluded that it was irrelevant that the disputant may not have been aware of the full details of the arrangement or that its knowledge did not extend to all steps and transactions by which the arrangement was carried into effect.

The Commissioner had asserted that the purpose of section BG 1 would be hindered if taxpayers could allege they

were unaware of the full particulars of an arrangement and therefore should avoid the application of the general anti-avoidance rule. The Commissioner submitted that the disputant's contentions did not support the purpose of section BG 1 and the TRA agreed.

In addition, the TRA considered that the arrangement had a purpose or effect of tax avoidance. The disputant claimed tax deductions that relieved it of liability to pay income tax (and any subsequent reversal of those deductions by the disputant did not erase that tax advantage) and so there was "tax avoidance" as defined. Further, the TRA was able to infer from the features of the arrangement that it had a clear purpose or effect of such tax avoidance.

The TRA also confirmed that once a tax avoidance arrangement is established, the arrangement is void as against the Commissioner and the Commissioner can adjust the deductions of any person affected by the arrangement so as to counteract the tax advantage. The TRA noted that there was no requirement that the relevant person be a party to the arrangement to be a person affected by the arrangement. The TRA ultimately held that regardless of whether or not the disputant was a party to the arrangement, it was affected by the arrangement in that it claimed deductions in respect of the EIF.

The effect of any fraud

Finally, the TRA also confirmed that, while there are indicators of fraud in this case, any fraud on the disputant by a third party is not relevant to the application of section BG 1. The disputant has legal remedies available to pursue against those third parties and this does not affect the Commissioner's ability to adjust the income of taxpayers who are affected by a tax avoidance arrangement.

COMMISSIONER SUCCESSFUL IN HER STRIKE-OUT APPLICATION

Case	TRA 40/10 [2012] NZTRA 09
Decision date	19 September 2012
Act(s)	Rule 2.50 of the District Court Rules 2009, section 17 and Part IVA of the Tax Administration Act 1994
Keywords	Strike-out application; Māori sovereignty; disputes process

Summary

The Commissioner was successful in having the disputant's claim struck out. The disputants may seek leave from the Taxation Review Authority ("TRA") to file an amended claim disputing the correctness of the Commissioner's assessments.

Impact of decision

This case reaffirms that everyone is subject to the laws of Parliament and Revenue Acts. Where there is a dispute over the amount of tax to pay, the disputant and the Commissioner are to engage in the disputes process. To challenge an assessment, the disputant should identify why and how the Commissioner's calculation of the tax owed should be corrected.

Facts

The disputant provides shearing services to farmers. However, from January 2005 the disputant stopped making PAYE tax deductions from wages payable to its employees and did not account to the Commissioner for those deductions.

The Commissioner commenced an investigation in early 2007. During an interview with the director of the disputant, the director expressed his view that the preamble to the Te Ture Whenua Māori Act 1993 means that no tax is required to be paid by the disputant.

In November 2007, the Commissioner issued pursuant to section 17 of the Tax Administration Act 1994, a request for disclosure of information and production of books and documents for inspection. The director of the disputant advised the Commissioner that the shareholders had passed a resolution transferring the shares to a trust. As the trust was constituted under a Māori Authority it could not provide the documents requested. The disputant said that to do so would be in breach of the regulations of the Māori Authority and Te Ture Whenua Māori Act 1993.

In January 2008, the Commissioner received a notice informing him that a hearing at Te Tii Waitangi Marae was set down for February 2008 to determine whether the disputant had to provide the information requested. The Commissioner responded advising that they would not be attending as the Commissioner did not recognise the Māori Court referred to.

The Commissioner issued a notice of proposed adjustment on 12 March 2009 proposing to amend the disputant's monthly employer schedules for the periods January 2005 to June 2007, to include payments to shearers and shed hands. PAYE was to be calculated on the payments to the shearers and shed hands.

A shortfall penalty for evasion was proposed.

The disputant responded with a notice of response and claimed that the information it provided was in breach of the Māori Authority's regulations. The disputant repeated its argument that it does not have to pay tax or provide any information to the Commissioner.

Despite attempts, no conference was held. The parties exchanged Statement of Positions that essentially repeated earlier arguments. The matter was referred to Inland Revenue's Adjudication Unit who concluded that the disputant was liable for tax deductions to be made under the PAYE rules from the wages paid to the shearers and shed hands. Notices of amended assessments for the income years in dispute were issued.

The disputant filed its notice of claim with the TRA. The Commissioner applied to have the claim struck out.

Decision

The TRA rejected the disputant's argument that it is under the authority of the Māori Authority and therefore is exempt from taxes. It held that the Revenue Acts apply to the disputant.

As the disputant is a taxpayer and obliged to pay taxes under the provisions of the Revenue Acts, the disputant must also comply with any section 17 notices issued by the Commissioner. The TRA held that the Commissioner cannot be estopped from performing his statutory functions. If the Commissioner had no power to obtain confidential information, the whole taxation system and its rationale would break down as the burden of taxation would fall only on diligent and honest taxpayers.

The TRA accepted that the Commissioner had followed the disputes procedure and engaged with the disputant to discuss the tax in dispute. The Commissioner had also acted in good faith throughout this dispute. However, the TRA recognised that the disputant mistakenly continued to argue that it was not liable to pay tax.

The TRA recognised that the disputant could dispute the correctness of the Commissioner's assessments on the basis that the shearers were independent contractors and not employees. To do this, the disputant would have to set out why and how the Commissioner's calculation of tax owed by the disputant is to be corrected. As the disputant's pleadings were confusing and misguided, the TRA allowed the disputant one month to apply to the TRA to amend its pleadings. Leave was also allowed for the disputant to argue that the shortfall penalty for evasion is not appropriate. The TRA considered it is arguable that the disputant was sincere in its views about Māori sovereignty affecting its PAYE responsibilities.

The disputant's claim was struck out. The disputant has one month to apply to the TRA, if it chooses, to pursue the issue of whether the shearers or shed hands were employees or independent contractors. The disputant may also apply to argue that a lower level of shortfall penalty should be imposed.

COMMISSIONER AWARDED INDEMNITY COSTS

Case	Commissioner of Inland Revenue v Accent Management Limited (and others) and Garry Albert Muir
Decision date	14 September 2012
Act(s)	Rule 14.6(4)(a) High Court Rules
Keywords	Indemnity costs, Trinity Scheme, abuse of process

Summary

The Commissioner was awarded indemnity costs on the basis that some of the Trinity investors acted vexatiously, frivolously, improperly, or unnecessarily in commencing and continuing with their unsuccessful application to debar Crown Law from acting for the Commissioner.

Impact of decision

A further award of indemnity costs represents another success for the Commissioner in the Trinity Scheme litigation. The High Court characterised the taxpayers' unsuccessful application as an attempt to game the system and as an abuse of process justifying indemnity costs.

Facts

The Commissioner of Inland Revenue ("the Commissioner") applied for indemnity costs, or in the alternative increased costs, as a result of the taxpayers' unsuccessful application for orders that Crown Law cease acting as the solicitors for the Commissioner and that no Crown counsel appear as counsel in certain proceedings for the Commissioner.

The taxpayers' original application to debar Crown Law was heard over two days by Justice Woodhouse in the High Court. Justice Woodhouse gave a judgment, *Accent Management Limited v Commissioner of Inland Revenue* (2011) 25 NZTC 20-022 (HC) (which is currently under appeal) on 22 June 2012 dismissing the taxpayer's application.

Decision

Justice Woodhouse noted the Commissioner's application was pursuant to rule 14.6(4)(a) of the High Court Rules which provides for indemnity costs where a "party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing, continuing, or defending a proceeding or step in a proceeding".

The Judge noted the circumstances listed by the Court of Appeal in *Bradbury v Westpac Banking Corporation* [2009] NZCA 234, [2009] 3 NZLR 400 in which indemnity costs had been ordered and noted those which the Commissioner stated applied in this case, being [3]:

a) particular misconduct that causes loss of time to the Court and other parties;

b) commencing or continuing proceedings for some ulterior motive;

c) doing so in wilful disregard of known facts or clearly established law;

d) making allegations which ought never to have been made or unduly prolonging a case by groundless contentions; that is, advancing a hopeless case.

Justice Woodhouse reproduced at length the findings from his substantive judgment, *Accent Management Limited v Commissioner of Inland Revenue* (2011) 25 NZTC 20-022 (HC) in [4], [45], [53] and [54] including findings at [53] of that judgment:

> … this application is an attempt to game the system … it is an attempt to game the system within the statutory procedures …. [T]he taxpayers have not brought this application because of a sincere and well-founded concern that their tax affairs will not be properly adjudicated on, but in an endeavour to cause unjustified difficulties for the Commissioner and to delay resolution of the tax disputes. The attempt to game the system, through the present applications, may be seen from the litigation history.

Further at [54]:

> I am also satisfied that these applications are an abuse of process.

Justice Woodhouse rejected the taxpayers' submissions that the issue of indemnity costs should either be deferred as the original High Court judgment is under appeal or in the alternative that the taxpayers should be able to address the Court on the individual findings which are being appealed and are relevant to this costs application.

The Judge held that deferral would be contrary to principle and general practice of the Courts. Further, the Court of Appeal could address any matter arising from the High Court decision if appropriate and a decision would be consistent with rule 1.2 of the High Court Rules requiring "just, speedy, and inexpensive determination of any proceeding or interlocutory application".

The alternative submission was rejected as it amounted to an application to re-argue matters that had been determined and effectively ignored an order already made.

Justice Woodhouse concluded that the Commissioner was entitled to indemnity costs of $56,184.10 exclusive of goods and services tax plus reasonable disbursements on the basis of his earlier findings in the substantive judgment.

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