

TAX INFORMATION

Bulletin

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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

IN SUMMARY

Binding rulings

BR Pub 13/05–13/06: Income tax – Standard project agreement for a public–private partnership

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These two public rulings, BR Pub 13/05 to BR Pub 13/06, deal with certain aspects of the income tax treatment of the standard form contract for public–private partnerships prepared by the Treasury. These two rulings do not consider the tax implications of any funding agreements or other contracts entered into by the parties.

Legislation and determinations

Determination DEP86: Tax depreciation rates general determination number 86

25

The Commissioner has added into the “Agriculture, Horticulture and Aquaculture” industry category the new asset class, estimated useful life, and general diminishing value and straight line depreciation rates for Frost Fan (mobile).

New legislation

Order in Council

27

Income Tax (Minimum Family Tax Credit) Order 2013

The Income Tax (Minimum Family Tax Credit) Order 2013, made on 21 October 2013, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from \$22,724 to \$22,776 a year from 1 April 2014.

Legal decisions – case notes

Application to suspend bankruptcy pending appeal dismissed by the Court of Appeal

28

Mr Bioletti was adjudicated bankrupt on 21 August 2013. A request for suspension of bankruptcy was sought pending appeal. The application was dismissed by the Court.

Commissioner successful in establishing that a section 167(1) trust survives liquidation

29

This case was an appeal from the High Court which held that the statutory trust pursuant to section 167(1) of the Tax Administration Act 1994 is extinguished upon a company being liquidated. The majority of the Court of Appeal overturned the decision of the High Court and concluded after consideration of the legislative scheme and history and applicable case law that an established section 167(1) trust will not be extinguished upon liquidation.

Intention or purpose of one or more trustees attributable to trust as a whole

30

The decision by the Taxation Review Authority (“TRA”) held that two of the three trustees, Mr and Mrs B, had the intention or purpose to sell when each of the relevant properties was acquired. This intention or purpose was attributable to the Trust as a whole, despite the third trustee asserting that she had no such purpose or intention. The TRA also held that the Trust’s activities amounted to a business of erecting buildings and a taxable activity for goods and services tax (“GST”) purposes. Accordingly, the trustees of the Trust were found to be jointly and severally liable to pay income tax and GST output tax on the sale proceeds from seven properties. The TRA also found that shortfall penalties for gross carelessness applied.

Legal decisions – case notes continued

Challenge of Commissioner's assessments

32

This was a capital/revenue case involving a sale and purchase of a shopping centre that was partially completed at the time of sale. The Commissioner of Inland Revenue considered that the Sale and Purchase Agreement contained two separate agreements, one for the completed portion of the shopping centre (an undeveloped land) as at the time of the agreement, and the other for subsequent development of the undeveloped portion.

The Commissioner assessed the taxpayer on the basis that monies received for the subsequent development were revenue receipts and taxable income. The taxpayer argued there was only one agreement and that all payments were capital receipts and not taxable. The Taxation Review Authority found for the taxpayer and cancelled the Commissioner's assessments.

Trinity investor's application to set aside the Commissioner's statutory demand dismissed by High Court

33

An application made by the plaintiff to set aside the Commissioner of Inland Revenue's statutory demand application. The plaintiff submitted that the amount claimed by the Commissioner was yet to be determined. The Court found that the amount owing had been determined in an earlier judgment and ordered the plaintiff to pay the sum of \$819,268.18 within 10 working days of this judgment.

Application to stay judgment pending appeal dismissed

35

The plaintiffs had previously unsuccessfully applied to have the Commissioner of Inland Revenue's statutory demands set aside. This application was to stay the orders of the judgment of Faire AJ, pending the hearing and determination of an appeal. The plaintiff's application was refused.

Taxpayer's section 89M(11) application dismissed

37

The taxpayer applied to the High Court for leave to bring an Originating Application, for more time to reply to the Commissioner of Inland Revenue's Statement of Position ("SOP") under section 89M(11) of the Tax Administration Act 1994. The High Court declined the application. Ronald Young J agreed with the Commissioner's position that there was no right of reply to the Commissioner's SOP in a taxpayer-initiated dispute.

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 *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)*. You can download this publication free from our website at www.ird.govt.nz

BR PUB 13/05–13/06: INCOME TAX – STANDARD PROJECT AGREEMENT FOR A PUBLIC–PRIVATE PARTNERSHIP

Summary

These two public rulings, BR Pub 13/05 to BR Pub 13/06, deal with certain aspects of the income tax treatment of the standard form contract for public–private partnerships prepared by the Treasury. These two rulings do not consider the tax implications of any funding agreements or other contracts entered into by the parties.

The two rulings are contained in a single document with a shared commentary.

Note (not part of the Rulings)

These two public rulings, BR Pub 13/05 to BR Pub 13/06, deal with certain aspects of the income tax treatment of the standard form contract for public–private partnerships prepared by the Treasury. These two rulings do not consider the tax implications of any funding agreements or other contracts entered into by the parties. For example, these rulings do not address the potential application of the thin capitalisation rules in subpart FE, goods and services tax (GST), the financial arrangements rules or the general anti avoidance provision in s BG 1.

Any person entering into a public-private partnership with the New Zealand Government is strongly advised to apply for a private ruling and a financial arrangements rules determination in respect of its specific structure to provide certainty on issues that are not addressed in these rulings.

PUBLIC RULING – BR PUB 13/05: INCOME TAX – STANDARD PROJECT AGREEMENT FOR A PUBLIC–PRIVATE PARTNERSHIP – COMPANIES

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

Taxation Laws

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

This Ruling applies in respect of ss CB 1, CH 2, DA 1, DA 2, DB 50, EA 2 and EA 3.

The Arrangement to which this Ruling applies

The Arrangement is the design, construction, operation and maintenance of an asset (the Facility) by a company (the special purpose vehicle—SPV) under a public–private partnership agreement with Her Majesty, The Queen in Right of New Zealand acting by and through a government department (the Crown).

The Arrangement is governed by a standard form contract prepared by the Treasury (the Project Agreement). Key clauses of the Project Agreement and relevant definitions have been included in Appendix B to the Commentary of this Ruling. This Ruling will not apply if the clauses of the Project Agreement that are referred to in this Ruling are altered in a material way.

The Project Agreement has three main components:

- The **Design and Construction (D&C) Phase** involves the SPV providing design and construction supplies in return for a lump sum design and construction payment (the D&C Payment).
- The **Facility Lease** is the lease into which the SPV and the Crown enter and under which the SPV prepays an amount representing the rental the SPV will pay to the Crown (the Rental Prepayment).
- The **Operation and Maintenance (O&M) Phase** involves the SPV providing operational and maintenance services over a period of approximately 25 years in return for a regular payment (the Unitary Charge). The date on which the O&M Phase starts is referred to as the Service Commencement Date.

Each of the three components is summarised below. The Project Agreement details the rights and obligations of the SPV and the Crown.

Design and Construction Phase

During the D&C Phase, the SPV will design and construct the Facility in accordance with the Project Agreement on behalf of the Crown. The Facility consists of all of the structures that are to be designed, constructed, commissioned and maintained by the SPV in accordance with the terms of the Project Agreement, and includes the entire physical infrastructure, the grounds and all of the fixtures, fit-out, plant and equipment. The SPV will be solely responsible to the Crown for the design and construction of the Facility, including the provision of infrastructure, plant, equipment and other related obligations, to the standard required by the Project Agreement.

Throughout the term of the Project Agreement, the SPV will not own the Facility or the land on which the Facility will be built (the Crown Site) (cl 11.1). Under cl 11.2(a) of the Project Agreement, any Fixtures that the SPV supplies before the start of the Facility Lease (whether or not affixed to the land) (the Initial Fixtures) will remain the property, and in the ownership, of the SPV until the date of payment of the D&C Payment. For the purposes of the Project Agreement, Fixtures includes all buildings (including component parts of buildings), other structures, improvements, and roads. If the Crown fails to pay the D&C Payment in full when it is due, the SPV can exercise its ownership rights and remove the Initial Fixtures (cl 11.2(b)). The ownership of the Initial Fixtures retained by the SPV under cl 11.2(a) will be automatically transferred to the Crown on the date of payment of the D&C Payment (cl 11.2(c)).

The D&C Payment is a single, contractually fixed, lump sum that the Crown must pay to the SPV on the Service Commencement Date. The D&C Payment is paid to the SPV by the Crown in consideration for the completion of the Facility and the transfer of the ownership in the Initial Fixtures (cl 12.3). No milestone or progress payments are provided for under the Project Agreement.

The amount of the D&C Payment is determined by direct reference to the agreed design and construction costs of the Facility (excluding fit-out) together with the SPV's funding costs during the D&C Phase. Under cl 12.5(c), the Crown and the SPV agree that the D&C Payment includes capitalised interest to the extent that it exceeds the agreed design and construction costs of the Facility. The SPV does not apply a separate margin in respect of the D&C Phase. The D&C Payment is set off against the amount payable by

the SPV as the Rental Prepayment for the Facility Lease, as described below.

To construct the Facility, the SPV will incur expenditure in connection with designing, obtaining, affixing, constructing and implementing the Initial Fixtures. Other than the costs of fit-out and any funding costs, the expenditure incurred by the SPV on the Facility during the D&C Phase is referred to in this Ruling as the D&C Expenditure.

Facility Lease

Clause 12.2 of the Project Agreement provides for the Crown and the SPV to enter into a lease in respect of the Facility on or before the date of operational completion. Operational completion is the point at which the SPV has met all the completion criteria specified in the Project Agreement.

On the Service Commencement Date, the SPV will be obliged to pay the Rental Prepayment to the Crown, representing the rental to be paid under the Facility Lease (cl 12.3 of the Project Agreement). The Rental Prepayment is (in whole) a payment in the nature of rent that the SPV will make for the use and enjoyment of the land covered by the lease, and substitutes for the rent that the SPV would otherwise need to pay over the term of the lease. Clause 12.4 of the Project Agreement provides for the D&C Payment and the Rental Prepayment to be set off against each other. The total amount of the Rental Prepayment payable by the SPV will equal the amount of the D&C Payment payable by the Crown.

Operation and Maintenance Phase

During the O&M Phase, the SPV must provide ongoing operational and maintenance services to the Crown as described in the Project Agreement. Broadly, the operational and maintenance services are those services necessary to meet the asset management requirements and will vary depending on the type of asset being constructed.

Under cl 49.1 of the Project Agreement, the Crown will pay the SPV a regular payment for the ongoing services provided (the Unitary Charge). The Unitary Charge will be paid following receipt by the Crown of a valid invoice (as defined in cl 49.2) issued by the SPV in accordance with cl 49.3. Payment of the Unitary Charge may be monthly or quarterly, depending on the nature of the Facility.

The amount of the Unitary Payment may include incentive payments and will be subject to abatement if the SPV does not meet key performance measures. The total amount of the Unitary Payment over the O&M Phase is expected to recover all of the SPV's costs in relation to the project and provide for its profit margin.

Termination of the Project Agreement

The Project Agreement will terminate at the conclusion of the Facility Lease and the O&M Phase, at which time any fit-out will be transferred to the ownership of the Crown for no consideration.

The Project Agreement may also be terminated early if either party defaults on its obligations. For the purposes of this Ruling, the Arrangement does not include any early termination that may take place, and this Ruling does not rule on the consequences of early termination.

Other contracts

To fulfil its obligations under the Project Agreement, the SPV will enter into funding agreements and subcontracts. For the purposes of this Ruling, the Arrangement does not include these other agreements or subcontracts or any ownership structures that may be entered into.

These agreements and subcontracts, together with the Project Agreement, will be an “arrangement” as defined in s YA 1 (the wider arrangement. For the avoidance of doubt, this Ruling does not apply where the Project Agreement is part of a wider arrangement that is a “tax avoidance arrangement” (as defined in s YA 1) such that subpart BG applies to void the wider arrangement.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

D&C Payment

- A portion of the D&C Payment will be income under the financial arrangements rules in subpart EW. To the extent that the D&C Payment is not income under the financial arrangements rules:
 - the D&C Payment will be income of the SPV under s CB 1(1) and will not be of a capital nature under s CB 1(2); and
 - for the purposes of s CB 1, the SPV will derive the D&C Payment on the Service Commencement Date.

D&C Expenditure

- The D&C Expenditure is deductible under s DA 1(1), provided that s DA 2(2) to (6) does not apply. The capital limitation in s DA 2(1) does not apply to the D&C Expenditure.
- The SPV’s interest in the Initial Fixtures is “revenue account property” as defined in s YA 1. For the purpose of s DB 23, the cost of this revenue account property is equal to the D&C Expenditure.
- Section EA 2 applies to the D&C Expenditure, because the D&C Expenditure is the cost of the “revenue account property”. Under s EA 2(2), the deduction for the D&C Expenditure will be allocated to the year in which the

Service Commencement Date takes place, because that is when the SPV disposes of the “revenue account property”.

- Section GC 1 will not apply to the disposal of the SPV’s interest in the Initial Fixtures.

Rental Prepayment

- The Rental Prepayment is deductible under s DA 1(1). The capital limitation in s DA 2(1) does not apply to the Rental Prepayment.
- The accrual expenditure rules (in ss EA 3, CH 2 and DB 50) apply to the Rental Prepayment each year from the Service Commencement Date. To the extent of the unexpired amount (determined under s EA 3(4)) of the Rental Prepayment at the end of an income year, an amount of income is derived by the SPV in that income year and the SPV is allowed a deduction for this amount in the subsequent income year.
- The SPV must spread the Rental Prepayment on a straight-line basis over the period of the lease term in order to determine the value of the unexpired portion of expenditure under s EA 3.

Unitary Charge

- Each partner’s share of the Unitary Charge (calculated in accordance with s HG 2) will be assessable income of the partner under s CB 1.
- For the purpose of s BD 3, each partner will derive the Unitary Charge in the income year in which the SPV issues a valid invoice to the Crown.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 21 October 2013.

This Ruling is signed by me on 21 October 2013.

Howard Davis

Director, Taxpayer Rulings

PUBLIC RULING – BR PUB 13/06: INCOME TAX – STANDARD PROJECT AGREEMENT FOR A PUBLIC–PRIVATE PARTNERSHIP – PARTNERSHIPS

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

Taxation Laws

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

This Ruling applies in respect of ss CB 1, CH 2, DA 1, DA 2, DB 50, EA 2 and EA 3.

The Arrangement to which this Ruling applies

The Arrangement is the design, construction, operation and maintenance of an asset (the Facility) by a partnership (as that term is defined in s YA 1) (the special purpose vehicle—SPV) under a public–private partnership agreement with Her Majesty, The Queen in Right of New Zealand acting by and through a government department (the Crown). The definition of “partnership” in s YA 1 includes a limited partnership and a joint venture that chooses to be treated as a partnership.

The Arrangement is governed by a standard form contract prepared by Treasury (the Project Agreement). Key clauses of the Project Agreement and relevant definitions have been included in Appendix B to the Commentary of this Ruling. This Ruling will not apply if the clauses of the Project Agreement that are referred to in this Ruling are altered in a material way.

The Project Agreement has three main components:

- The **Design and Construction (D&C) Phase** involves the SPV providing design and construction supplies in return for a lump sum design and construction payment (the D&C Payment).
- The **Facility Lease** is the lease into which the SPV and the Crown enter and under which the SPV prepays an amount representing the rental the SPV will pay to the Crown (the Rental Prepayment).
- The **Operation and Maintenance (O&M) Phase** involves the SPV providing operational and maintenance services over a period of approximately 25 years in return for a regular payment (the Unitary Charge). The date on which the O&M Phase starts is referred to as the Service Commencement Date.

Each of the three components is summarised below. The Project Agreement details the rights and obligations of the SPV and the Crown.

Design and Construction Phase

During the D&C Phase, the SPV will design and construct the Facility in accordance with the Project Agreement on behalf of the Crown. The Facility consists of all of the structures that are to be designed, constructed, commissioned and maintained by the SPV in accordance with the terms of the Project Agreement, and includes the entire physical infrastructure, the grounds and all of the fixtures, fit-out, plant and equipment. The SPV will be solely responsible to the Crown for the design and construction of the Facility, including the provision of infrastructure, plant, equipment and other related obligations, to the standard required by the Project Agreement.

Throughout the term of the Project Agreement, the SPV will not own the Facility or the land on which the Facility will be built (the Crown Site) (cl 11.1). Under cl 11.2(a) of the Project Agreement, any Fixtures that the SPV supplies before the start of the Facility Lease (whether or not affixed to the land) (the Initial Fixtures) will remain the property, and in the ownership, of the SPV until the date of payment of the D&C Payment. For the purposes of the Project Agreement, Fixtures includes all buildings (including component parts of buildings), other structures, improvements, and roads. If the Crown fails to pay the D&C Payment in full when it is due, the SPV can exercise its ownership rights and remove the Initial Fixtures (cl 11.2(b)). The ownership of the Initial Fixtures retained by the SPV under cl 11.2(a) will be automatically transferred to the Crown on the date of payment of the D&C Payment (cl 11.2(c)).

The D&C Payment is a single, contractually fixed, lump sum that the Crown must pay to the SPV on the Service Commencement Date. The D&C Payment is paid to the SPV by the Crown in consideration for the completion of the Facility and the transfer of the ownership in the Initial Fixtures (cl 12.3). No milestone or progress payments are provided for under the Project Agreement.

The amount of the D&C Payment is determined by direct reference to the agreed design and construction costs of the Facility (excluding fit-out) together with the SPV’s funding costs during the D&C Phase. Under cl 12.5(c), the Crown and the SPV agree that the D&C Payment includes capitalised interest to the extent that it exceeds the agreed design and construction costs of the Facility. The SPV does not apply a separate margin in respect of the D&C Phase. The D&C Payment is set off against the amount payable by the SPV as the Rental Prepayment for the Facility Lease, as described below.

To construct the Facility, the SPV will incur expenditure in connection with designing, obtaining, affixing, constructing and implementing the Initial Fixtures. Other than the costs of fit-out and any funding costs, the expenditure incurred by the SPV on the Facility during the D&C Phase is referred to in this Ruling as the D&C Expenditure.

Facility Lease

Clause 12.2 of the Project Agreement provides for the Crown and the SPV to enter into a lease in respect of the Facility on or before the date of operational completion. Operational completion is the point at which the SPV has met all the completion criteria specified in the Project Agreement.

On the Service Commencement Date, the SPV will be obliged to pay the Rental Prepayment to the Crown,

representing the rental to be paid under the Facility Lease (cl 12.3 of the Project Agreement). The Rental Prepayment is (in whole) a payment in the nature of rent that the SPV will make for the use and enjoyment of the land covered by the lease, and substitutes for the rent that the SPV would otherwise need to pay over the term of the lease. Clause 12.4 of the Project Agreement provides for the D&C Payment and the Rental Prepayment to be set off against each other. The total amount of the Rental Prepayment payable by the SPV will equal the amount of the D&C Payment payable by the Crown.

Operation and Maintenance Phase

During the O&M Phase, the SPV must provide ongoing operational and maintenance services to the Crown as described in the Project Agreement. Broadly, the operational and maintenance services are those services necessary to meet the asset management requirements and will vary depending on the type of asset being constructed.

Under cl 49.1 of the Project Agreement, the Crown will pay the SPV a regular payment for the ongoing services provided (the Unitary Charge). The Unitary Charge will be paid following receipt by the Crown of a valid invoice (as defined in cl 49.2) issued by the SPV in accordance with cl 49.3. Payment of the Unitary Charge may be monthly or quarterly, depending on the nature of the Facility.

The amount of the Unitary Payment may include incentive payments and will be subject to abatement if the SPV does not meet key performance measures. The total amount of the Unitary Payment over the O&M Phase is expected to recover all of the SPV's costs in relation to the project and provide for its profit margin.

Termination of the Project Agreement

The Project Agreement will terminate at the conclusion of the Facility Lease and the O&M Phase, at which time any fit-out will be transferred to the ownership of the Crown for no consideration.

The Project Agreement may also be terminated early if either party defaults on its obligations. For the purposes of this Ruling, the Arrangement does not include any early termination that may take place, and this Ruling does not rule on the consequences of early termination.

Other contracts

To fulfil its obligations under the Project Agreement, the SPV will enter into funding agreements and subcontracts. For the purposes of this Ruling, the Arrangement does not include these other agreements or subcontracts or any ownership structures that may be entered into.

These agreements and subcontracts, together with the Project Agreement, will be an "arrangement" as defined in

s YA 1 (the wider arrangement. For the avoidance of doubt, this Ruling does not apply where the Project Agreement is part of a wider arrangement that is a "tax avoidance arrangement" (as defined in s YA 1) such that subpart BG applies to void the wider arrangement.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

D&C Payment

- A portion of the D&C Payment will be income under the financial arrangements rules in subpart EW. To the extent that the D&C Payment is not income under the financial arrangements rules:
 - each partner's share of the D&C Payment (calculated in accordance with s HG 2) will be income of the partner under s CB 1(1) and will not be of a capital nature under s CB 1(2); and
 - for the purposes of s CB 1, each partner will derive the D&C Payment on the Service Commencement Date.

D&C Expenditure

- Subject to s HG 11 in the case of a "limited partnership" (as defined in s YA 1), each partner's share of the D&C Expenditure (calculated in accordance with s HG 2) is deductible under s DA 1(1), provided that s DA 2(2) to (6) does not apply. The capital limitation in s DA 2(1) does not apply to the D&C Expenditure.
- Each partner's share of the SPV's interest in the Initial Fixtures (calculated in accordance with s HG 2) is "revenue account property" as defined in s YA 1. For the purpose of s DB 23, the cost of this revenue account property is equal to the D&C Expenditure.
- Section EA 2 applies to the D&C Expenditure, because the D&C Expenditure is the cost of the "revenue account property". Under s EA 2(2), the deduction for the D&C Expenditure will be allocated to the year in which the Service Commencement Date takes place, because that is when the "revenue account property" is disposed of.
- Section GC 1 will not apply to the disposal of each partner's share of the SPV's interest in the Initial Fixtures.

Rental Prepayment

- Subject to s HG 11 in the case of a "limited partnership" (as defined in s YA 1), each partner's share of the Rental Prepayment (calculated in accordance with s HG 2) is deductible under s DA 1(1). The capital limitation in s DA 2(1) does not apply to the Rental Prepayment.
- The accrual expenditure rules (in ss EA 3, CH 2 and DB 50) apply to the Rental Prepayment each year from the Service Commencement Date. To the extent of the unexpired amount (determined under s EA 3(4)) of the Rental Prepayment at the end of an income year,

an amount of income is derived by each partner in that income year and the partner is allowed a deduction for this amount in the subsequent income year.

- Each partner must spread their share of the Rental Prepayment (calculated in accordance with s HG 2) on a straight-line basis over the period of the lease term in order to determine the value of the unexpired portion of expenditure under s EA 3.

Unitary Charge

- Each partner's share of the Unitary Charge (calculated in accordance with s HG 2) will be assessable income of the partner under s CB 1.
- For the purpose of s BD 3, each partner will derive the Unitary Charge in the income year in which the SPV issues a valid invoice to the Crown.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 21 October 2013.

This Ruling is signed by me on 21 October 2013.

Howard Davis

Director, Taxpayer Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 13/05 AND BR PUB 13/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 13/05 and BR Pub 13/06 (the Public Rulings).

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

Background

1. The Treasury has prepared a standard form contract to govern all public–private partnership (PPP) projects in New Zealand (the Project Agreement). Key clauses of the Project Agreement are included in Appendix B. The Project Agreement will form the basis of the agreement between the Crown and the preferred or successful bidder (the special purpose vehicle—SPV) in any future PPP project.
2. The Project Agreement also forms the basis of the Arrangement on which the Public Rulings are issued. The Public Rulings set out the income tax treatment of the main components of the Project Agreement.

Tax Administration Act 1994

3. Under Part 5A of the Tax Administration Act 1994 (TAA), the Commissioner has the ability to make binding rulings. The purpose of this ability is to provide taxpayers with certainty about the way the Commissioner will apply taxation laws and to help taxpayers to meet their obligations under those laws (s 91A).
4. Under s 91D, the Commissioner can make public rulings on how a taxation law applies to any type of person and any type of arrangement. Public rulings interpret how a taxation law applies to a specific type of arrangement that has a wide general application. The Public Rulings are public rulings that set out how the income tax laws apply to the standard form Project Agreement, as the Project Agreement will be used as the basis for all future PPP projects. Provided that the relevant clauses of the Project Agreement are not amended in a material way, the Public Rulings will apply to give certainty to future preferred bidders regarding the application of the taxation laws contained in the Public Rulings.
5. Under s 91E, the Commissioner can make private rulings on how a taxation law applies to a specific person(s) and a specific arrangement on which the ruling is sought. A private ruling can be applied for by a preferred bidder in relation to the specific structure being entered into, to give certainty on the application of the taxation laws to that structure (particularly in relation to taxation laws that are not included in the Public Rulings). For more information on private rulings, see our booklet *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)* which is available from the Inland Revenue website.
6. The term “taxation law” is defined in s 91C, which provides that the Commissioner can make a ruling on most provisions of the Income Tax Act 2007. For current purposes, the key exception is that the Commissioner is unable to make a ruling where the matter is or could be the subject of a determination under s 90AC (which relates to the application of the financial arrangements rules). This means that the Commissioner is unable to provide a binding ruling in respect of many issues relating to the application of the financial arrangements rules in subpart EW, but must instead make a financial arrangements rules determination under s 90AC in order to give taxpayers certainty.
7. Therefore, in order for a bidder to obtain certainty in relation to the application of the taxation laws in any particular PPP project, it is likely that a combination

of the Public Rulings, a private ruling and a financial arrangements rules determination will be necessary.

8. Any preferred or successful bidder is strongly advised to apply for a private ruling and a financial arrangements rules determination in respect of its specific structure to provide certainty on any issues that are not addressed in the Rulings. The Crown may require the successful bidder to obtain a favourable private ruling in respect of issues not addressed in the Public Rulings.

Application of the Legislation

9. The term SPV is used in this commentary as a generic term to refer to the successful bidder who enters into a Project Agreement with the Crown. It is used in this commentary to refer to either a company or a partner's share in a partnership, as relevant.

SPV is carrying on a "business"

10. The term "business" is defined in s YA 1, and includes "any profession, trade, or undertaking carried on for profit". The leading New Zealand case on the meaning of "business" is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA).
11. In *Grieve*, Richardson J held that determining whether a business existed involved a two-fold enquiry into the:
 - nature of the activities carried on; and
 - intention of the taxpayer in engaging in those activities.
12. By entering into the Project Agreement with the Crown, the SPV will be responsible for the design and construction of the Facility and the provision of ongoing operational services to the Crown over a period of approximately 25 years. The SPV will also intend to make a profit from entering into the Project Agreement through the receipt of the Unitary Charge.
13. Therefore, the SPV will have the requisite level of activities and intention to profit and will be carrying on a "business" (as defined in s YA 1). This will be the case even if all of the obligations under the Project Agreement are subcontracted to other persons.

Application of the financial arrangement rules

14. The Project Agreement is a "financial arrangement" as defined in s EW 3, and will be part of a wider financial arrangement that also includes any funding agreements and subcontracts the SPV enters into.
15. The Design and Construction (D&C) Phase of the Project Agreement is a financial arrangement as defined in s EW 3. Under the D&C Phase, the SPV will receive consideration from the Crown (in the form of the D&C Payment) and will provide consideration

to the Crown (in the form of the Facility). The SPV and the Crown agree that the D&C Payment includes capitalised interest (cl 12.5(c) of the Project Agreement). The effect of cl 12.5(c) will be that part of the D&C Payment will be income under the financial arrangements rules in subpart EW. It is likely that Commissioner would determine that the amount of income will be equal to the capitalised interest that the parties agree is included in the D&C Payment. However, to obtain certainty on this point, the SPV is strongly advised to apply for a financial arrangements rules determination, which will determine the value of the Facility (under s EW 32(6) of the Income Tax Act 2007 and s 90AC of the Tax Administration Act 1994), the amount of income derived under the financial arrangement rules and how that income should be spread over the term of the D&C Phase.

16. It is likely that no income or expenditure arises under the financial arrangement rules in subpart EW in relation to the Facility Lease and the Operation and Maintenance (O&M) Phase of the Project Agreement, for the following reasons:
 - The Facility Lease is an excepted financial arrangement under s EW 5(9). The Rental Prepayment is solely attributable to that excepted financial arrangement, so is not taken into account under the financial arrangement rules in accordance with s EW 6(2).
 - The O&M Phase is a "short-term agreement for sale and purchase" (as defined in s YA 1) of services and is an excepted financial arrangement under s EW 5(22). In accordance with s EW 6(3), amounts solely attributable to this excepted financial arrangement are taken into account under the financial arrangement rules. However, because the consideration the SPV pays (that is, the services provided to the Crown) is equal in value to the consideration the SPV receives (the Unitary Charge), there is no amount to spread under the financial arrangement rules.
17. Therefore, the SPV must recognise amounts paid and received under the Facility Lease and the O&M Phase of the Project Agreement as income derived or expenditure incurred under the relevant provisions of the Income Tax Act 2007 (outside the financial arrangement rules) in accordance with the Public Rulings.
18. Any successful bidder is strongly advised to apply for a financial arrangements rules determination in respect of its specific structure. See Special Determination S22: "Application of the financial arrangements rules

to a public-private partnership" (*Tax Information Bulletin* Vol 24, No 9 (October/November 2012)) for an example of a financial arrangements rules determination issued in respect of a PPP project dealing with similar issues.

Design and Construction Payment

19. As noted in para 15, to the extent that the D&C Payment consists of capitalised interest, the financial arrangements rules in subpart EW apply to the D&C Payment. The remainder of the D&C Payment will be an amount that the SPV derives from a business, so will be income under s CB 1(1). The D&C Payment will not be of a capital nature under s CB 1(2).
20. Other than any amount required to be spread under the financial arrangements rules, the SPV will derive the D&C Payment on the Service Commencement Date in consideration for performing its obligations under the Project Agreement and the transfer of the SPV's ownership interest in the Initial Fixtures.

Design and Construction Expenditure

21. Clause 11.2 of the Project Agreement makes it clear that the SPV retains ownership of the Initial Fixtures and disposes of that ownership on the Service Commencement Date in consideration for the D&C Payment. The ownership interest retained by the SPV in the Initial Fixtures (under cl 11.2) is "revenue account property" (as defined in s YA 1). The "cost" of the revenue account property is equal to the D&C Expenditure. Therefore, s DB 23 applies to override the capital limitation in s DA 2(1).
22. As the SPV is in business, the D&C Expenditure will be deductible under s DA 1. The capital limitation in s DA 2(1) will not apply to the D&C Expenditure, because of the application of s DB 23. Whether the other limitations in s DA 2 apply to the D&C Expenditure will depend on the nature of the structure and other arrangements the SPV enters into, which is outside the scope of the Public Rulings.
23. Section EA 2 applies to determine the timing of the deduction for the D&C Expenditure. Section EA 2(2) provides that the SPV will be entitled to a deduction for the cost of revenue account property in the earlier of the income year in which the person disposes of the property or the property ceases to exist.
24. Under the Project Agreement, the SPV will dispose of the "revenue account property" for the D&C Payment on the Service Commencement Date. Therefore, the SPV will be entitled to claim a deduction for the D&C Expenditure in the income year in which the Service Commencement Date occurs.

Matching of Design and Construction Expenditure and Payment

25. The effect of the above conclusions are that the D&C Expenditure will be deductible to the SPV in the same income year that the SPV receives the D&C Payment, being the income year in which the Service Commencement Date occurs.

Rental Prepayment

26. The courts have held that if a taxpayer incurs rental expenditure as part of their income-earning process that expenditure will be of a revenue nature: *FCT v South Australian Battery Makers Pty Ltd* (1978) 78 ATC 4,412; *Wattie v CIR* (1996) 17 NZTC 12,712.
27. The Rental Prepayment is (in whole) a payment in the nature of rent that the SPV will make for the use and enjoyment of the land covered by the Facility Lease, and substitutes for the rent that the SPV would otherwise need to pay over the term of the Facility Lease. That the Lease Prepayment is "prepaid" in one lump sum does not change its character for tax purposes: *JP Hancock v General Reversionary and Investment Co Ltd* [1919] 1 KB 25; *J Gadsden & Co v CIR* [1965] NZLR 385; *National Australia Bank Ltd v FC of T* (1997) 37 ATR 378.
28. As the SPV is in business and the Facility Lease is part of its income-earning process, the Rental Prepayment will be deductible under s DA 1. The Rental Prepayment will not be subject to the capital limitation in s DA 2(1).
29. Section EA 3 applies in relation to the timing of the deduction for the Rental Prepayment. Where s EA 3 applies, s EA 3(3) states:
 - The unexpired portion of a person's expenditure at the end of an income year—
 - (a) is income of the person in the income year under section CH 2 (Adjustment for prepayments); and
 - (b) is an amount for which the person is allowed a deduction in the following income year under section DB 50 (Adjustment for prepayments).
30. The Rental Prepayment is made in respect of the Facility Lease, which is a "good" for the purposes of s EA 3 (being an interest in land and therefore real property). The Rental Prepayment is not made in respect of services, a chose in action or an allowance reimbursing employees. Therefore, the unexpired portion must be determined in accordance with s EA 3(4).
31. Section EA 3(4) states that an amount of expenditure on goods is unexpired at the end of an income year if the:
 - person has not used up the goods in deriving income; and

- goods are not destroyed or rendered useless for the purpose of deriving income.
32. The term “used” in the context of s EA 3(4) means being expended through being consumed or incorporated into other assets: *Thornton Estates Ltd v CIR* (1998) 18 NZTC 13,577 (CA).
33. In the context of a lease of property, the goods are used up evenly over the term of the lease. The unexpired portion at the end of an income year will cover the portion of the expenditure that relates to the portion of the lease that is yet to take place.
34. Therefore, the “unexpired” portion of the Rental Prepayment, in terms of s EA 3(4), will be the portion that relates to the outstanding term of the lease at the end of each income year. This means the Rental Prepayment will be spread evenly over the term of the lease (on a straight-line basis).

Unitary Charge

35. Because the SPV is in business, the Unitary Charge will be income of the SPV under s CB 1.
36. Section BD 3 requires every amount of income to be allocated to the income year in which it is derived. Case law on the meaning of the term establishes that an amount is “derived” when the income-earning process is complete. Once the SPV has undertaken the operational and maintenance services and issued the Crown with a valid invoice (as defined in cl 49.2 of the Project Agreement), the income-earning process will be complete and the Unitary Charge will have been derived.

Section BG 1

37. It is the Commissioner’s opinion that the Project Agreement is not a “tax avoidance arrangement” (as defined in s YA 1) for the purposes of s BG 1. However, as noted in the Public Rulings, the Project Agreement is part of a wider arrangement that also consists of any funding agreements and subcontracts that the SPV may enter into.
38. For the purposes of s BG 1, the wider arrangement will be an “arrangement” (as defined in s YA 1) and the Commissioner could potentially conclude that the wider arrangement entered into by the SPV is a “tax avoidance arrangement” that is void pursuant to s BG 1.
39. Although the Commissioner considers it unlikely, if s BG 1 applied to the wider arrangement, any reconstruction under s GA 1 could potentially affect the conclusions reached in the Public Rulings in relation to the income tax treatment of the Project Agreement. The Commissioner is unable to reach a conclusion on the application of s GA 1 and the

- appropriate reconstruction to make without knowing the full details of the “tax avoidance arrangement” entered into. For this reason, the Public Rulings do not and cannot rule on the potential application of s BG 1.
40. It is the Commissioner’s view that s BG 1 is unlikely to apply to any arrangement where:
- the funding agreements are straight-forward loans entered into on an arm’s length basis with third-party lenders on market terms;
 - any related party funding does not have any artificial features and is entered into on an arm’s length basis on market terms; and
 - any subcontracts are entered into on an arm’s length basis on market terms.
41. However, because each particular PPP arrangement entered into will differ, the Commissioner needs to consider the facts of any arrangement entered into before reaching a definitive conclusion on the potential application of s BG 1. Any successful bidder is strongly advised to apply for a private binding ruling in respect of its specific arrangement if it wants certainty regarding the Commissioner’s view on s BG 1.

References

Subject references
Public–private partnership (PPP)
Legislative references
Income Tax Act 2007, ss CB 1, CH 2, DA 1, DA 2, DB 50, EA 2 and EA 3 and subpart EW
Case references
<i>FCT v South Australian Battery Makers Pty Ltd</i> (1978) 78 ATC 4,412
<i>Grieve v CIR</i> (1984) 6 NZTC 61,682 (CA)
<i>J Gadsden & Co v CIR</i> [1965] NZLR 385
<i>JP Hancock v General Reversionary and Investment Co Ltd</i> [1919] 1 KB 25
<i>National Australia Bank Ltd v FC of T</i> (1997) 37 ATR 378
<i>Thornton Estates Ltd v CIR</i> (1998) 18 NZTC 13,577 (CA)
<i>Wattie v CIR</i> (1996) 17 NZTC 12,712
Other references
<i>Binding rulings: How to get certainty on the tax position of your transaction</i> (IR 715)
Special Determination S22: “Application of the financial arrangements rules to a public–private partnership” <i>Tax Information Bulletin</i> Vol 24, No 9 (October/November 2012)

APPENDIX A – LEGISLATION

Income Tax Act 2007

1. Section BD 3 provides:

BD 3 Allocation of income to particular income years

Application

- (1) Every amount of income must be allocated to an income year under this section.

General rule

- (2) An amount of income is allocated to the income year in which the amount is derived, unless a provision in any of Parts C or E to I provides for allocation on another basis.

Interpretation of derive

- (3) When the time of derivation of an amount of income is being determined, regard must be had to case law, which—
- (a) requires some people to recognise income on an accrual basis; and
 - (b) requires other people to recognise income on a cash basis; and
 - (c) more generally, defines the concept of derivation. Income credited in account
- (4) Despite subsection (3), income that has not previously been derived by a person is treated as being derived when it is credited in their account or, in some other way, dealt with in their interest or on their behalf.

Role of Part E

- (5) Part E (Timing and quantifying rules) contains a number of provisions that—
- (a) specifically modify the allocation of income or have the effect of modifying the allocation of income; or
 - (b) allocate income as part of the process of quantifying it.

Single allocation

- (6) An amount of income may be allocated only once.

2. Section CB 1 provides:

CB 1 Amounts derived from business

Income

- (1) An amount that a person derives from a business is income of the person.

Exclusion

- (2) Subsection (1) does not apply to an amount that is of a capital nature.

3. Section CH 2 provides:

CH 2 Adjustment for prepayments

When this section applies

- (1) This section applies when a person has, under section EA 3 (Prepayments), an unexpired amount of expenditure at the end of an income year.

Income

- (2) The unexpired amount is income of the person in the income year.

4. Section DA 1 provides:

DA 1 General permission

Nexus with income

- (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
- (a) incurred by them in deriving—
 - (i) their assessable income; or
 - (ii) their excluded income; or
 - (iii) a combination of their assessable income and excluded income; or
 - (b) incurred by them in the course of carrying on a business for the purpose of deriving—
 - (i) their assessable income; or
 - (ii) their excluded income; or
 - (iii) a combination of their assessable income and excluded income.

General permission

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

Avoidance arrangements

- (3) Section GB 33 (Arrangements involving depreciation loss) may apply to override the general permission in relation to an amount of depreciation loss.

5. Section DB 2 provides:

DA 2 General limitations

Capital limitation

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

Private limitation

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

Exempt income limitation

- (3) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving exempt income. This rule is called the **exempt income limitation**.

Employment limitation

- (4) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving income from employment. This rule is called the **employment limitation**.

Withholding tax limitation

- (5) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving non-resident passive income of the kind referred to in section RF 2(3) (Non-resident passive income). This rule is called the **withholding tax limitation**.

Non-residents' foreign-sourced income limitation

- (6) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving non-residents' foreign-sourced income. This rule is called the **non-residents' foreign-sourced income limitation**.

Relationship of general limitations to general permission

- (7) Each of the general limitations in this section overrides the general permission.

6. Section DB 23 provides:

DB 23 Cost of revenue account property*Deduction*

- (1) A person is allowed a deduction for expenditure that they incur as the cost of revenue account property.

No deduction

- (2) Despite subsection (1), a person is denied a deduction for expenditure incurred as the cost of revenue account property if—
- Repealed.
 - section CX 55, CX 56B, or CX 56C (which relate to portfolio investment income) applies to income derived by the person from the disposal of the revenue account property.

Link with subpart DA

- (3) Subsection (1) overrides the capital limitation but the general permission must still be satisfied. Subsection (2) overrides the general permission. The other general limitations still apply.

7. Section DB 50 provides:

DB 50 Adjustment for prepayments*When this section applies*

- (1) This section applies when a person has, under section EA 3 (Prepayments), an unexpired amount of expenditure at the end of an income year.

Deduction

- (2) The person is allowed a deduction for the unexpired amount for the following income year.

Link with subpart DA

- (3) This section supplements the general permission. The general limitations still apply, but not to the extent to which any relevant general limitation was overridden by a provision that initially allowed a deduction for the expenditure, whether in this Act or an earlier Act.

8. Section EA 2 provides:

EA 2 Other revenue account property*When this section applies*

- (1) This section applies to revenue account property that is not—
- trading stock valued under subpart EB (Valuation of trading stock (including dealer's livestock));
 - livestock valued under subpart EC (Valuation of livestock);
 - an excepted financial arrangement valued under subpart ED (Valuation of excepted financial arrangements);
 - a film or a film right to which sections EJ 4toEJ 8 (which relate to films) apply;
 - a specified lease or a lease to which section EJ 10 (Personal property lease payments) applies;
 - property that arises as a result of petroleum development expenditure or petroleum exploration expenditure to which sections EJ 12toEJ 20 (which relate to petroleum mining) apply;
 - a financial arrangement valued under subpart EW (Financial arrangements rules).

Timing of deduction

- (2) A deduction for the cost of revenue account property of a person is allocated to the earlier of—
- the income year in which the person disposes of the property; and
 - the income year in which the property ceases to exist.

9. Section EA 3 provides:

EA 3 Prepayments*When this section applies*

- (1) This section applies when—
- a person has been allowed a deduction for expenditure under this Act or an earlier Act; and
 - the expenditure was not incurred on the items described in subsection (2); and
 - some or all of the expenditure is unexpired under subsections (4) to (7) at the end of the person's income year.

Exclusions

- (2) This section does not apply to expenditure incurred on—
- revenue account property to which section EA 2 applies;
 - trading stock valued under subpart EB (Valuation of trading stock (including dealer's livestock));

- (c) livestock valued under subpart EC (Valuation of livestock):
- (d) an excepted financial arrangement valued under subpart ED (Valuation of excepted financial arrangements):
- (e) a film or a film right to which sections EJ 4 to EJ 8 (which relate to films) apply:
- (f) a specified lease or a lease to which section EJ 10 (Personal property lease payments) applies:
- (g) property that arises as a result of petroleum development expenditure or petroleum exploration expenditure to which sections EJ 12 to EJ 20 (which relate to petroleum mining) apply:
- (h) a financial arrangement valued under subpart EW (Financial arrangements rules).

Unexpired portion

- (3) The unexpired portion of a person's expenditure at the end of an income year—
 - (a) is income of the person in the income year under section CH 2 (Adjustment for prepayments); and
 - (b) is an amount for which the person is allowed a deduction in the following income year under section DB 50 (Adjustment for prepayments).

Unexpired portion: expenditure on goods

- (4) An amount of expenditure on goods is unexpired at the end of an income year if, by the end of the income year,—
 - (a) the person has not used up the goods in deriving income; and
 - (b) the goods are not destroyed or rendered useless for the purpose of deriving income.

Unexpired portion: expenditure on services

- (5) An amount of expenditure on services is unexpired at the end of an income year if the services have not been performed by the end of the income year.

Unexpired portion: expenditure on choses in action

- (6) An amount of expenditure on a chose in action is unexpired at the end of an income year if the amount relates to a period of enforceability of the chose in action falling after the income year.

Allowances reimbursing employees

- (7) In the case of expenditure subject to sections CW 17, CW 17B, CW 17C, and CW 18 (which relate to expenditure, reimbursement, and allowances of employees), this section applies on the basis that the relevant services were performed in the income year in which the employee's expenditure is expected to occur.

Commissioner's discretionary relief

- (8) The Commissioner may excuse a person from complying with this section under section 91AAC of the Tax Administration Act 1994.

10. Section HG 2 provides:

HG 2 Partnerships are transparent

Look-through in accordance with share

- (1) For the purposes of a partner's liabilities and obligations under this Act in their capacity of partner of a partnership, unless the context requires otherwise,—
 - (a) the partner is treated as carrying on an activity carried on by the partnership, and having a status, intention, and purpose of the partnership, and the partnership is treated as not carrying on the activity or having the status, intention, or purpose:
 - (b) the partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property:
 - (c) the partner is treated as being party to an arrangement to which the partnership is a party, in proportion to the partner's partnership share, and the partnership is treated as not being a party to the arrangement:
 - (d) the partner is treated as doing a thing and being entitled to a thing that the partnership does or is entitled to, in proportion to the partner's partnership share, and the partnership is treated as not doing the thing or being entitled to the thing.

No streaming

- (2) Despite subsection (1), for a partner in their capacity of partner of a partnership, the amount of income, tax credit, rebate, gain, expenditure, or loss that they have from a particular source, or of a particular nature, is calculated by multiplying the total income, tax credit, rebate, gain, expenditure, or loss of the partners of the partnership from the particular source or of the particular nature by the partner's partnership share in the partnership's income.

Expenditure or loss previously incurred

- (3) A partner of a partnership may be treated as incurring an expenditure or loss which the partnership incurs ignoring this section, despite the partner not being a partner at the time the expenditure or loss is incurred. This subsection does not allow 2 deductions for 1 expenditure or loss.

Excluded amounts

- (4) Subsection (2) does not apply to the following amounts:

- (a) expenditure or loss that relates to a person entering a partnership by acquiring partner's interests disposed of by another partner, to the extent to which sections HG 5 to HG 10 do not apply to the partner's interests:
- (b) supplementary dividends, to the extent to which subpart LP (Tax credits for supplementary dividends) applies:
- (c) Repealed.
- (d) imputation credits, to the extent to which section LE 6 (Partners in partnerships) applies:
- (e) FDP credits, to the extent to which section LF 4 (Partners in partnerships) applies.

11. Section HG 11 provides:

HG 11 Limitation on deductions by partners in limited partnerships

When this section applies

- (1) This section applies for a limited partnership and an income year when, but for this section, a deduction by virtue of section HG 2 or HG 12 is allowed to—
 - (a) a limited partner of the limited partnership:
 - (b) a general partner of the partnership who—
 - (i) was a limited partner of the limited partnership within 60 days of the last day of the income year; and
 - (ii) is or will be a limited partner of the limited partnership within 60 days after the last day of the income year.

No deduction

- (2) The partner is denied the deduction for an income year to the extent to which their limited partnership deduction for the income year is greater than the amount (the **partner's basis**) calculated using the formula in subsection (3) on the last day of the income year.

Partner's basis

- (3) For the purposes of subsection (2), the amount that is the partner's basis is calculated using the following formula:

$$\text{investments} - \text{distributions} + \text{income} - \text{deductions} - \text{disallowed amount.}$$

Definition of items in formula

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

Investments

- (5) **Investments** is the total of—
 - (a) the market value of capital contributions made by the partner to the limited partnership at the time the relevant contribution is contributed or agreed to be contributed by them:

- (b) the amount paid by the partner for the assignment of capital contributions to them:
- (c) the secured amounts.

Distributions

- (6) **Distributions** is the total of—
 - (a) the market value of distributions to the partner from the limited partnership:
 - (b) the amount paid to the partner for the assignment of capital contributions by them.

Income

- (7) **Income** is the total of—
 - (a) income that the partner has by virtue of section HG 2 in the income year and previous income years:
 - (ab) if the partner has FIF income or a FIF loss, an amount under subsection (7B):
 - (b) capital gain amounts under section CD 44(7)
 - (a) (Available capital distribution amount) that the partner would have by virtue of section HG 2 in the income year and previous income years, if the partner were treated as a company for the purposes of section CD 44(7)(a), unless the gain is accounted for under paragraph (a):
 - (c) assessable income that the partner has in previous income years from goods and services they contributed to the limited partnership, if the income is not accounted for under subsection (5) or paragraph (a) or (b) of this subsection.

Formula

- (7B) The amount described in subsection (7)(ab) is given by the following formula, but if the calculation returns a negative number, the amount is zero:

$$\text{dividend} - \text{FIF amount.}$$

Definition of items in formula

- (7C) In the formula,—
 - (a) **dividend** is the amount that would be the partner's share of the dividend paid by a FIF to the limited partnership, if section CD 36(1) (Foreign investment fund income) were ignored:
 - (b) **FIF amount** is—
 - (i) zero, if subparagraph (ii) does not apply:
 - (ii) the amount that is the person's FIF income, for the relevant income year and FIF, if the person has such an amount.

Deductions

- (8) **Deductions** is the total of—
 - (a) expenditure or loss in previous income years, to the extent to which the expenditure or

loss is incurred by virtue of section HG 2 in the partner deriving income by virtue of section HG 2, excluding any deductions denied in those previous years under this section:

- (b) capital loss amounts under section CD 44(9) that the partner would have by virtue of section HG 2 in the income year and previous income years..., if the partner is treated as a company for the purposes of section CD 44(9), unless the loss is accounted for under paragraph (a):
- (c) deductions that the partner is allowed in previous income year in relation to assessable income described in subsection (7)(c), if the deduction is not accounted for under subsection (6) or paragraphs (a) or (b) of this section.

Disallowed amounts

- (9) **Disallowed amount** is the amount of investments, as defined in subsection (5), made by the partner within 60 days of the last day of the income year, if those investments are or will be distributed or reduced within 60 days after the last day of the income year.

Exclusion

- (10) This section does not deny a partner (the exiting partner) a deduction that is equal to or less than the amount of net income that the exiting partner has for the amount paid or payable to the exiting partner for the disposal of their partner's interests, ignoring other transactions.

Relationship with subject matter

- (11) This section is modified by sections HZ 3, HZ 4 and HZ 4B (which relate to transitions to limited partnerships).

Some definitions

- (12) In this section,—

capital contribution includes—

- (a) a capital contribution for the purposes of the Limited Partnerships Act 2008:
- (b) amounts that the limited partnership is debtor for in relation to the partner, including a loan to the limited partnership and a credit balance in a current account

guarantor means—

- (a) a partner, if—
 - (i) the partner secures the relevant debt by guarantee or indemnity:
 - (ii) the partner's associate secures the relevant debt by guarantee or indemnity:

- (b) a person who is not described in paragraph (a)(i) and (ii) but who secures the relevant

debt by guarantee or indemnity, if the partner or a partner's associate also secures the relevant debt as described in paragraph (a)(i) and (ii)

limited partnership deduction means, for the partner and the income year, the amount of any deductions that the partner would be allowed if the partner is treated as having no income or deductions other than those that arise by virtue of sections HG 2 and HG 12

partner's associate means, for a partner, a person who is not a partner of the relevant limited partnership, and who is—

- (a) a relative of the partner, but excluding a person under section YA 1 (Definitions), definition of "relative", paragraph (v):
- (b) a company in the same wholly-owned group as the partner

recourse property means property to which a creditor has recourse, to enforce a guarantee or indemnity for the relevant debt, if the guarantee or indemnity expressly provides recourse to only that property

secured amounts means, for the partner, the lesser of the following applicable amounts—

- (a) the amount of the limited partnership's debt ignoring section HG 2 (the secured debt) for which the partner is a guarantor, divided by the total number of guarantors for the secured debt:
- (b) the market value of the recourse property for the secured debt to the extent of the interest that the partner and the partner's associates have in it, net of higher-ranking calls whether actual, future, or contingent, divided by the total number of guarantors described in the definition of "guarantor", paragraph (a), who have an interest in the recourse property or have a partner's associate with an interest in the recourse property.

- 12. Section YA 1 contains the following relevant definitions:

business—

- (a) includes any profession, trade, or undertaking carried on for profit:
- (b) includes the activities of—
 - (i) a statutory producer board:
 - (ii) an airport operator:
- (c) is further defined in section DD 11 (Some definitions) for the purposes of subpart DD (Entertainment expenditure)

limited partnership—

- (a) means a limited partnership registered under the Limited Partnerships Act 2008; and

- (b) includes an “overseas limited partnership” as defined in section 4 of that Act; and
- (c) despite paragraph (a) or (b), does not include a listed limited partnership or a foreign corporate limited partnership

revenue account property, for a person, means property that—

- (a) is trading stock of the person;
- (b) if disposed of for valuable consideration, would produce income for the person other than income under section EE 48 (Effect of disposal or event), FA 5 (Assets acquired or disposed of after deductions of payments under lease), or FA 9 (Treatment when lease ends: lessee acquiring asset);
- (c) is an emissions unit of the person;
- (d) is a non-Kyoto greenhouse gas unit

partnership means—

- (a) a group of 2 or more persons who have, between themselves, the relationship described in section 4(1) of the Partnership Act 1908;
- (b) a joint venture, if the joint venturers all choose to be treated as a partnership for the purposes of this Act and the Tax Administration Act 1994;
- (c) co-owners of property, other than persons who are co-owners only because they are shareholders of the same company, or settlors, trustees, or beneficiaries of the same trust, if the co-owners all choose to be treated as a partnership for the purposes of this Act and the Tax Administration Act 1994;
- (d) a limited partnership

APPENDIX B – KEY CLAUSES FROM THE PROJECT AGREEMENT

The following clauses are those that the Commissioner considers key to the issues considered in the Public Rulings. The Public Rulings will not apply if these clauses of the Project Agreement are altered in a material way.

1. Clause 11 states:

11. Construction of Facilities for Crown

11.1 Ownership of Facility

- (a) The Facility shall be designed and constructed by the Contractor under and in accordance with this Agreement on behalf of the Crown.
- (b) Subject to the rights of the Contractor set out in this Part 5, the Crown will at all times before and after the Service Commencement Date own the Facility (excluding the Fitout, to which clause 11.2(e) applies) and the Crown Site.

11.2 Ownership of Fixtures and Fitout

- (a) Any Fixtures supplied by the Contractor prior to the commencement of the term of the Facility Lease (Initial Fixtures) will remain the property, and in the ownership, of the Contractor (notwithstanding any affixing to the Crown Site) until the earlier of:
 - (i) the date of payment in full of the Design and Construction Payment; and
 - (ii) the date of payment in full of the Compensation Sum,
 (such date being the **Transfer Date**).
- (b) The Crown acknowledges and agrees that the Contractor shall, until the Transfer Date, have the right (in addition and without prejudice to its other rights and remedies under the Project Documents, including the rights of access set out in Part 7 (Access to Site and Site Issues)) to enter and re-enter on to the Crown Site and remove and repossess the Initial Fixtures, but only if and to the extent the Crown fails to pay in full:
 - (i) the Design and Construction Payment in accordance with clauses 12.3 (Payments on Service Commencement Date) and 12.4 (Set-off); or
 - (ii) the Compensation Sum in accordance with clause 79.1 (Payment of Compensation Sum), in each case within 5 Business Days after the due date for payment of such amount under this Agreement.
- (c) Upon the Transfer Date, the Contractor shall immediately transfer to the Crown its ownership of the Initial Fixtures together with all associated rights in and to the Initial Fixtures and the Crown Site reserved under clause 11.2(b). The Initial Fixtures will automatically vest in the Crown on the Transfer Date, by operation of this clause, without the need for any additional action by any person.
- (d) The expenditure incurred by or for the Contractor in connection with the Initial Fixtures will be included in the Design and Construction Payment.
- (e) Any Fitout on the Crown Site will belong to the Contractor until the earlier of the Actual Termination Date and the Expiry Date. On such date, the Fitout will be transferred by the Contractor to the Crown, for no additional consideration, as part of the Disengagement Deliverables in accordance with clause 85 (Contractor’s Disengagement Deliverables), the terms of Schedule 24 (Disengagement) and the requirements of the Disengagement Plan.

- (f) Any Fixtures in respect of which the Contractor has incurred expenditure, other than for repairs and maintenance, after the commencement of the Facility Lease will be treated as owned by the Contractor rather than the Crown for the purposes of this Agreement. On the earlier of the Expiry Date and the Actual Termination Date, any such Fixtures, to the extent ownership is vested in the Contractor, will be transferred by the Contractor to the Crown, for no additional consideration, as part of the Disengagement Deliverables in accordance with clause 85 (Contractor's Disengagement Deliverables), the terms of Schedule 24 (Disengagement) and the requirements of the Disengagement Plan.

2. Clause 12 states:

12. Facility Lease and payments on Service Commencement Date

12.1 Prior to Service Commencement Date

The Contractor will, prior to the Service Commencement Date, have the rights to access the Crown Site set out in Part 7 (Access to Site and Site Issues).

12.2 Entry into Facility Lease

- (a) On or prior to the Crown issuing the Operational Completion Notice, the parties must enter into the Facility Lease. The Facility Lease will have a term commencing at 9.00am on the Service Commencement Date and terminating on the earlier of the Actual Termination Date and the Expiry Date.
- (b) If the Contractor requires registration of the Facility Lease under the Land Transfer Act 1952, each party must do all things necessary to enable the Facility Lease to be registered in the form of a lease instrument at Land Information New Zealand via e-dealing, including without limitation signing an authority and instruction form (so that the relevant solicitor is authorised to provide the certifications required by section 164A of the Land Transfer Act 1952).

12.3 Payments on Service Commencement Date

On the Service Commencement Date, immediately on commencement of the Facility Lease:

- (a) the Crown must pay the Design and Construction Payment to the Contractor in consideration of the completion of the Facility and the transfer of the rights set out in clause 11.2(c) (Ownership of Fixtures and Fitout); and
- (b) the Contractor must pay the Rental Prepayment to the Crown, representing the

rental to be prepaid under the Facility Lease, with the payments to be made in accordance with clause 12.3 (Payments on Service Commencement Date).

12.4 Set off

- (a) The Crown's obligation to pay the Design and Construction Payment to the Contractor and the Contractor's obligation to pay the Rental Prepayment to the Crown:
- (i) will arise at the same time; and
- (ii) will be set off against each other immediately on the obligations arising, with the set-off to be recorded in a written notice given by the Crown to the Contractor.
- (b) GST payable as between the parties in respect of the Rental Prepayment and the Design and Construction Payment will be addressed in accordance with clauses 49.8 (Zero rating of Facility Lease) and 49.9 (Design and Construction Payment – GST).

12.5 Financial Arrangements Rules

For the purposes of the financial arrangements rules in the Income Tax Act 2007, the parties agree that:

- (a) they are independent parties dealing at arm's length with each other in relation to the Project;
- (b) the Rental Prepayment is the lowest price the parties would have agreed for the rental of the Facility for the term of the Facility Lease, on the date of this Agreement, if payment had been required in full at the time the first right in the Facility Lease passes from the Crown to the Contractor;
- (c) the Design and Construction Payment includes capitalised interest to the extent that it exceeds the agreed design and construction costs (which by definition exclude Fitout and debt funding costs) of the Facility;
- (d) the Rental Prepayment is the value of the rental under the Facility Lease and therefore does not include any capitalised interest; and
- (e) in the case of the Contractor only, it will compute its taxable income for the relevant period on the basis that the total consideration includes capitalised interest as set out in clause 12.5(c) above and it will file its Tax returns accordingly.

3. Clause 49 states:

49. Unitary Charge

49.1 Obligation to pay and sole remedy

- (a) The Crown must pay the Contractor the

Monthly Unitary Payment in respect of each Payment Period, calculated in accordance with Schedule 14 (Payment Mechanism).

- (b) Subject to clause 49.1(d), the sole remedies of the Crown in respect of a failure to provide the Operational Services in accordance with this Agreement are:
- (i) where Deductions are applicable for any such failure, the operation of Schedule 14 (Payment Mechanism);
 - (ii) the granting of injunctive relief, a decree of specific performance or other discretionary remedies available from any Court of competent jurisdiction (whether or not Deductions are applicable for any such failure); and
 - (iii) the remedies set out in clause 75 (Termination on Contractor Default).
- (c) Subject to clause 49.1(d), the sole remedies of the Crown in respect of any delay in respect of the carrying out of the Works Provisioning are:
- (i) where the Contractor fails to comply with clause 25.6 (Milestones) the remedies set out in clause 25.7 (Monitoring);
 - (ii) where the Service Commencement Date does not occur on or prior to the Planned Service Commencement Date, the remedies set out in clause 25.9 (Delays – liquidated damages); and
 - (iii) the remedies set out in clause 75 (Termination on Contractor Default) where the circumstances set out in clauses 75.2(a)(i), 75.2(a)(ii) or 75.2(a)(vi) apply.
- (d) In addition to its remedies under clauses 49.1(b) and 49.1(c), the Crown may exercise:
- (i) any other express right or remedy of the Crown under this Agreement; and
 - (ii) its right to claim, on or after termination of this Agreement, the amount of its costs, losses, damages and expenses suffered or incurred as a result of rectifying or mitigating the effects of:
 - (A) any breach of this Agreement by the Contractor; or
 - (B) any negligent act or omission on the part of the Contractor,
 after taking account of:
 - (C) sums already recovered by the Crown under this Agreement; and
 - (D) any compensation payable by the Crown under Part 19 (Termination).

49.2 Report and invoice

- (a) No later than the tenth Business Day of each Payment Period, the Contractor shall submit to the Crown:
- (i) a report certified by the Contractor:
 - (A) specifying the Monthly Unitary Payment for the immediately preceding Payment Period;
 - (B) setting out individually each item that has been taken into account in calculating the Monthly Unitary Payment in accordance with Schedule 14 (Payment Mechanism);
 - (C) setting out full details of any relief from Deductions claimed under clause 49.4;
 - (D) setting out any Additional Payments due to the Contractor and/or any Moneys Owing to the Crown;
 - (E) setting out a comprehensive explanation of the basis on which such Additional Payments are being claimed, and when the costs associated with such Additional Payments were incurred (including supporting documentation, where applicable); and
 - (F) setting out any other matters required to be included in that report in accordance with Schedule 12 (Service Requirements) and Schedule 7 (Governance and Service Management); and
 - (ii) an invoice (the form of which must have been previously approved by the Crown) (a **valid invoice**) for the amount (if any) shown by the report as owing by the Crown to the Contractor and for all GST payable by the Crown in respect of that amount.
- (b) If the Contractor becomes entitled to any Additional Payments prior to the Service Commencement Date, the Contractor shall submit to the Crown a valid invoice for such Additional Payments and a report certified by the Contractor setting out:
- (i) the Additional Payments due to the Contractor; and
 - (ii) a comprehensive explanation of the basis on which such Additional Payments are being claimed, and when the costs associated with such Additional Payments were incurred.

- (c) If the Contractor submits a report or an invoice that is incomplete, incorrect or in breach of clause 49.2(a) or clause 49.2(b), the Crown may reject the invoice and that invoice will not be considered as valid.

49.3 Payment

- (a) No moneys are payable to the Contractor by the Crown unless the Crown has received a valid invoice from the Contractor and the report for the Payment Period to which that invoice relates.
- (b) The Crown shall pay the amount stated in any valid invoice submitted under clause 49.2 on or before the 20th of the month following the month in which such invoice was received by the Crown (or if such day is not a Business Day, on the next Business Day) (the **Relevant Payment Date**). This clause 49.3(b) is subject to clause 49.5.
- (c) Payment of the Monthly Unitary Payment, any Additional Payment or any other moneys by the Crown to the Contractor does not constitute acceptance by the Crown that the Contractor has performed its obligations, nor does it constitute (nor is it to be construed as) a waiver of any of the Crown's rights and remedies, whether under this Agreement or at Law.
- (d) If a report shows a net amount owed by the Contractor to the Crown, then the Contractor shall pay that amount to the Crown on or before the 20th of the month following the month in which such report was received by the Crown (or if such day is not a Business Day, on the next Business Day).
- (e) Except where otherwise specifically provided in this Agreement, where any payment due from the Contractor to the Crown or from the Crown to the Contractor under any provision of this Agreement is not paid on or before its due date, it shall bear interest at the Prescribed Rate from the due date (whether before or after any judgment) until the date of actual payment.
- (f) All moneys payable to or by the Crown under this Agreement are to be invoiced and paid only in Dollars.

49.4 Relief from Deductions

No Deductions may be made if and to the extent that it has been demonstrated to the reasonable satisfaction of the Crown that the event or circumstance giving rise to the Deduction is a direct result of:

- (a) a Confirmed Change implemented by the Contractor under clause 46.1 (Contractor's

obligations), to the extent specified in that Confirmed Change;

- (b) a Change implemented by or on behalf of the Crown under clause 46.2(c), to the extent agreed under clause 46.2(d);
- (c) Scheduled Maintenance being carried out in accordance with the Asset Management Plan and the requirements of this Agreement;
- (d) the Crown or the Retained Services Operator making a specific request or giving specific instructions to the Contractor (in any case, against the reasonable advice of the Contractor, and provided that the Contractor has advised the Crown or the Retained Services Operator in writing of the impact such request or instructions will have on the ability of the Contractor to perform its obligations under this Agreement;
- (e) an Intervening Event, for so long as and to the extent that the Contractor is eligible for relief in respect of that Intervening Event under Part 11 (Events); or
- (f) the Crown exercising its Step-in Rights under Part 17 (Crown Step-in).

49.5 Disputed Amounts

- (a) The Crown may withhold the payment of any amount invoiced by the Contractor that the Crown considers on reasonable grounds:
 - (i) is not an amount to which the Contractor is entitled under the terms of this Agreement; or
 - (ii) is not an amount to which the Contractor is entitled on the Relevant Payment Date,
 (each a **Disputed Amount**), pending agreement or determination with respect to that Disputed Amount.
- (b) The Crown must pay any amount invoiced by the Contractor that is not disputed by the Crown on or before the Relevant Payment Date.
- (c) The Crown shall notify the Contractor in writing within 10 Business Days of receipt by the Crown of the relevant invoice of any Disputed Amount, together with a report setting out:
 - (i) particulars as to the quantum of that Disputed Amount;
 - (ii) the reasons for such dispute; and
 - (iii) such supporting evidence as the Crown may wish to provide in respect of the dispute.
- (d) Within five Business Days following receipt by the Contractor of a notice served

by the Crown under clause 49.5(c), the Contractor shall respond by notifying the Crown as to whether or not it agrees with the statements made in that notice. If the Contractor indicates that it does agree, or if the Contractor fails to respond within five Business Days, the Crown will not be required to pay to the Contractor any amounts withheld under clause 49.5(a).

- (e) If the Contractor responds under clause 49.5(d) indicating that it does not agree with all or any of the statements made in a notice served by the Crown under clause 49.5(c), the matter or matters in question shall be determined in accordance with the Accelerated Dispute Resolution Procedures.
- (f) If it is agreed or determined that:
- (i) the Crown has withheld an amount that the Contractor was entitled to be paid; or
 - (ii) the Contractor has claimed under clause 49.2 an amount that it was not entitled to be paid,
- the Crown shall pay such amount to the Contractor or the Contractor shall repay such amount to the Crown (as applicable) together with interest on that amount at the Prescribed Rate from the date on which payment was or should have been made until all relevant monies have been paid in full (whether before or after judgment).
- (g) The Contractor is not excused from the performance of any of its obligations under this Agreement because the Crown has exercised its rights under this clause 49.5.

49.6 Rights of set-off

- (a) The Crown may at any time deduct from any amount payable to the Contractor:
- (i) any Moneys Owing to the Crown; and
 - (ii) any Claim to Moneys Owing which the Crown may have against the Contractor, under any Project Document.
- (b) The Contractor must not at any time deduct from money otherwise due to the Crown (including any Moneys Owing to the Crown) under any Project Document:
- (i) any debt or other money due from the Crown to the Contractor; or
 - (ii) any Claim to money which the Contractor may have against the Crown.
- (c) The Crown will provide the Contractor with reasonable details of the basis on which it is setting off any amount under this clause 49.6.
- (d) Notwithstanding clause 49.6(a), the Crown acknowledges that it will not be entitled

to deduct any Moneys Owing from any payment to or for the account of the Contractor if:

- (i) this Agreement has been terminated under clause 74 (Termination for Convenience), clause 76 (Termination on Uninsurable Event) or clause 77 (Termination on Uninsurability); and
- (ii) such deduction would reduce the amount payable to or for the account of the Contractor in connection with the termination of this Agreement to an amount less than the Base Senior Debt Termination Amount.

49.7 Goods and Services Tax (GST)

- (a) In this clause 49.7 and in clauses 49.8 and 49.9, words and phrases defined in the GST Act have the meaning given in that Act, unless the context requires otherwise.
- (b) Unless expressly provided to the contrary, any consideration payable for a supply made under this Agreement is stated before the addition of any GST chargeable on that supply.
- (c) The parties agree that where GST is chargeable on a supply made by one party (the **Supplier**) to the other party (the **Recipient**) under this Agreement, the Supplier will issue a tax invoice to the Recipient and the Recipient will pay to the Supplier the GST chargeable on that supply, in addition to the consideration payable for that supply, unless section 5(23) of the GST Act applies to that supply. Subject to clauses 49.8 and 49.9, the Recipient shall pay the GST to the Supplier at the same time as the consideration is paid to the Supplier.
- (d) The Contractor shall provide the Crown with any information reasonably requested by the Crown in relation to the amount of GST chargeable on a supply made under this Agreement and payable by the Crown to the Contractor.

49.8 Zero rating of Facility Lease

- (a) The Contractor undertakes that:
- (i) it will be a registered person on the Service Commencement Date and will provide its tax registration number to the Crown before that date;
 - (ii) it is acquiring the Facility Lease with the intention of using it for making taxable supplies;
 - (iii) it does not intend to use the Facility Lease as a principal place of residence for itself or a person treated as

associated with it under section 2A(1)(c) of the GST Act; and

- (iv) it will not at any time be a member of a group registered for GST under section 55 of the GST Act other than any group comprising the Contractor and HoldCo.
- (b) The parties agree that the supply of the Facility Lease evidences a supply of an interest in land and accordingly, in reliance on the Contractor's undertakings in clause 49.8(a), the Crown will treat the supply of the Facility Lease as zero rated for GST purposes under section 11(1)(mb) of the GST Act.
- (c) Unless section 5(23) of the GST Act applies to the supply of the Facility Lease, if for any reason it is determined that the supply of the Facility Lease is chargeable with GST other than at a rate of zero per cent, the Contractor shall be entitled to recover (and the Crown will pay to the Contractor) the amount of any direct costs (including penalties and interest, legal or other advisory costs, and any costs of financing the additional GST amount), resulting from the supply of the Facility Lease being chargeable with GST other than at a rate of zero per cent, on the Contractor providing reasonable evidence to the Crown of the Contractor's liability for such costs.

49.9 Design and Construction Payment – GST

- (a) Each party acknowledges and agrees that:
 - (i) the Design and Construction Payment is consideration for a taxable supply (the **Supply**) under the GST Act;
 - (ii) it will not seek to treat the Supply as zero rated for GST purposes; and
 - (iii) on or before the Service Commencement Date it will be registered under the GST Act on a monthly return cycle and on an "invoice" accounting basis.
- (b) Subject to clause 49.9(c), the Crown must pay the GST chargeable on the Supply to the Contractor by no later than one Business Day prior to the date on which that GST is due to be paid by the Contractor to Inland Revenue.
- (c) If the Crown wishes to satisfy its obligation to pay the GST chargeable on the Supply to the Contractor by way of a GST offset (as agreed with Inland Revenue), the parties will each use their reasonable endeavours to agree on any documentation and other arrangements required to facilitate that offset.

49.10 Rates and Taxes

- (a) The Crown is responsible for and will pay all Rates and Taxes assessed on or in relation to the Crown Site, except to the extent that the Contractor causes such Rates or Taxes or any applicable penalty component to be assessed by or as a result of an act or omission of the Contractor.
 - (b) Subject only to clause 49.10(a), the Contractor will pay all Rates and Taxes assessed on it, under any Project Document or any transaction evidenced or contemplated by it or in respect of, or because of its involvement in the Project.
 - (c) The Contractor will use its reasonable endeavours to ensure that any Rates or Taxes for which the Crown is liable under clause 49.10(a) are invoiced directly by the relevant Governmental Entity to the Crown. Where any invoices for which the Crown is liable under clause 49.10(a) are addressed to the Contractor rather than to the Crown, the Crown will meet the invoiced costs by way of an Additional Payment.
4. Clause 1 contains the following key definitions:

Design and Construction Payment means a payment of the amount specified in cell *[insert reference]* of the Base Case sheet entitled *[insert title]* as at Financial Close, to be made by the Crown to the Contractor on the Service Commencement Date, representing the agreed design and construction costs of the Facility (excluding Fitout) which includes an allocation of the Contractor's debt funding costs, as incurred or deemed incurred during or prior to the Works Provisioning phase;

Facility means all of the structures located or to be located on the Crown Site, that together or separately are to be designed, constructed, commissioned and maintained by the Contractor in accordance with the terms of this Agreement, including:

- (a) the entire physical infrastructure on the Crown Site (including Works Infrastructure);
- (b) the grounds situated within the Crown Site;
- (c) all Fixtures and Fitout; and
- (d) all plant and equipment that is to be exclusively used in or as part of the Facility following Service Commencement,

and includes all Changes made to the Facility (or any part of them) under Part 12 (Changes);

Facility Lease means a deed of lease in the form set out in Annexure 4 to Schedule 3 (Project and Ancillary Documents);

Financial Close means the later of the dates on which:

- (a) all the Conditions Precedent are satisfied or waived, as set out in a notice given by the Crown under clause 10.4 (Conditions Precedent); and
- (b) the Effective Base Rate is first determined and incorporated in the Base Case;

Fitout means all alterations and additions, fittings and partitioning, service facilities, plant and machinery, furnishings, light fittings, and equipment, made to or installed in the Facilities by the Contractor, but excludes Fixtures;

Fixtures means those buildings, including component parts of buildings, other structures and improvements and other property that are or have become attached or affixed to the Crown Site and would at Law, at the relevant time, comprise a 'fixture' and, for the avoidance of doubt, for the purposes of this Agreement includes a road;

Operational Services means each and all of the services described in Schedule 12 (Service Requirements) and includes:

- (a) building management services;
- (b) building maintenance and refurbishment services;
- (c) utilities management services;
- (d) cleaning services;
- (e) waste management services;
- (f) grounds and gardens maintenance;
- (g) security services;
- (h) pest control services; and
- (i) *[insert any other services]*,

in each case to be provided in accordance with the Service Requirements;

Payment Period means each calendar month or (in the case of the first and final Payment Periods) part thereof during the period starting on the Service Commencement Date and ending on the last day of the Contract Term;

PPP means the New Zealand Government's public private partnership initiative;

Project Documents means those agreements listed as "Project Documents" in Part 1 (Overview of Project Documents and Ancillary Documents) of Schedule 3 (Project and Ancillary Documents) and includes any document or agreement entered into for the purpose of supplementing, amending, replacing or novating any of those listed documents that the parties have agreed (in writing) to be a Project Document;

Rental Prepayment means payment of the amount specified in *[insert Base Case reference as at Financial Close]* to be made by the Contractor to the Crown on the Service Commencement Date, representing the rental to be paid under the Facility Lease from its commencement until the earlier of the Actual Termination Date and the Expiry Date;

Service Commencement Date means the later of:

- (a) the day specified in the Operational Completion Notice on which all of the Operational Services are to commence; and
- (b) the day on which the Operational Services actually commence,

and **Service Commencement** shall have a corresponding meaning;

Unitary Charge means the fee payable by the Crown during the Operating Term in consideration of the obligations performed by the Contractor under this Agreement, as set out in the Base Case and as calculated and subject to adjustment in accordance with Schedule 14 (Payment Mechanism);

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 DEP86: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 86

Note to Determination DEP86

The Commissioner has set a general depreciation rate for Frost Fans (mobile) by adding a new asset class to the "Agriculture, Horticulture and Aquaculture" industry category.

Frost Fans (mobile) are used to protect crops from frost conditions and hot temperatures.

GENERAL DEPRECIATION DETERMINATION DEP86: FROST FAN (MOBILE)

1. Application

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

This determination applies from the 2013–14 and subsequent income years.

2. Determination

Pursuant to section 91AAF of the Tax Administration Act 1994 the general determination will apply to the kind of items of depreciable property listed in the table below by:

- adding into the "Agriculture, Horticulture and Aquaculture" industry category the new asset class, estimated useful life, and general diminishing value and straight line depreciation rates as listed below:

Agriculture, horticulture and aquaculture	Estimated useful life (years)	DV rate (%)	SL rate (%)
Frost Fan (mobile)	15.5	13	8.5

3. Interpretation

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

This determination is signed on the 5th day of November 2013.

Rob Wells

LTS Manager, Technical Standards

NEW LEGISLATION

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

ORDER IN COUNCIL

INCOME TAX (MINIMUM FAMILY TAX CREDIT) ORDER 2013

The Income Tax (Minimum Family Tax Credit) Order 2013, made on 21 October 2013, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from \$22,724 to \$22,776 a year from 1 April 2014.

The minimum family tax credit provides a guaranteed minimum family income to families who are in work and ensures they are no worse off moving off a benefit and into paid employment.

Key features

The order increases the prescribed amount in the definition in the formula for calculating the minimum family tax credit, in section ME 1(3)(a) of the Income Tax Act 2007.

The order also revokes the Income Tax (Minimum Family Tax Credit) Order 2011 as it is now spent. It amends the Income Tax (Minimum Family Tax Credit) Order 2012 to limit it to the 2013–14 tax year only.

Application date

The increase applies for the 2014–15 and later tax years.

Income Tax (Minimum Family Tax Credit) Order 2013 (SR 2013/438)

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.

APPLICATION TO SUSPEND BANKRUPTCY PENDING APPEAL DISMISSED BY THE COURT OF APPEAL

Case	Jeremy Newland Bioletti v Commissioner of Inland Revenue [2013] NZCA 465
Decision date	4 October 2013
Act(s)	Insolvency Act 2006
Keywords	Bankruptcy, right of appeal, stay

Summary

Mr Bioletti was adjudicated bankrupt on 21 August 2013. A request for suspension of bankruptcy was sought pending appeal. The application was dismissed by the Court.

Impact of decision

The same factors for whether a stay should be granted pending an appeal will apply when considering whether a suspension under section 416 of the Insolvency Act 2006 should be granted pending an appeal.

As with a stay, the application for a suspension should be made to the High Court in the first instance.

Facts

Lang J made an order adjudicating Mr Bioletti ("the applicant") bankrupt on 21 August 2013 (*Commissioner of Inland Revenue v Bioletti* [2013] NZHC 2131). The order was made on the application of the Commissioner of Inland Revenue ("the Commissioner"). The applicant sought a suspension of his adjudication pending appeal under section 416 of the Insolvency Act 2006. The Court directed that the application should have been made in the High Court (*Salem Ltd v Top End Homes Ltd* (2005) 18 PRNZ 122 at [115]) but dealt with it as it was already before them.

The Court applied the relevant factors as set out in the application for stay decision of *Keung v GBR Investment Ltd* [2010] NZCA 396, [2021] NZAR at [11] for convenience.

Issues and decision

The relevant factors are set out below.

Would the applicant's right of appeal be rendered nugatory if no stay is given?

The Court determined that the applicant's appeal right would not be rendered nugatory but would remain whether or not he is permitted to practice on his own account.

Bona fide

The Court held that there was no suggestion that Mr Bioletti would not pursue his appeal in good faith.

Would the successful party be injuriously affected by the stay?

The Commissioner submitted that due to the applicant's poor compliance history and increasing debt in the months leading up to the adjudication, the Commissioner would be adversely affected if the applicant could continue to practice free of the constraints imposed by bankruptcy. The Court accepted that there was some risk in that regard.

The effect on third parties

No suggestions of the effect on third parties were made in this case.

Novelty and importance of questions involved

The applicant submitted that the recent changes to the legal aid system had a significant adverse effect on his practice and ability to earn income and therefore bankruptcy should not have been pursued by the Commissioner.

The Court accepted that this was a novel argument but is particular to the applicant's circumstances and holds no importance beyond the present case. The Court went on to say that there does not appear to be a significant prospect of the argument being accepted.

Public interest

The Court did not see public interest as a factor of particular significance.

Balance of convenience

The balance of convenience was weighted considerably towards the Commissioner. The Court's considerations were as follows:

1. the applicant had not established any existing prejudice;
2. the amount of debt owed to the Commissioner;
3. the Commissioner should benefit from the decision of the High Court;
4. the increase in debt during the bankruptcy process; and
5. the Commissioner should not be exposed to further increases in debt in the event that the bankruptcy did not take effect until after the appeal.

Strength

The Court referred to its finding at [8] of the judgment that there does not appear to be a significant prospect of the applicant's argument being accepted.

COMMISSIONER SUCCESSFUL IN ESTABLISHING THAT A SECTION 167(1) TRUST SURVIVES LIQUIDATION

Case	Commissioner of Inland Revenue v Jennings Roadfreight Limited (in liq) [2013] NZCA 455
Decision date	1 October 2013
Act(s)	Tax Administration Act 1994
Keywords	Section 167(1), section 167(2), PAYE deductions, trust, liquidation

Summary

This case was an appeal from the High Court which held that the statutory trust pursuant to section 167(1) of the Tax Administration Act 1994 ("the Act") is extinguished upon a company being liquidated. The majority of the Court of Appeal overturned the decision of the High Court and concluded after consideration of the legislative scheme and history and applicable case law that an established section 167(1) trust will not be extinguished upon liquidation.

Impact of decision

Where PAYE deductions are held in trust under section 167(1) of the Act, the trust remains in existence upon liquidation and is not terminated by section 167(2). Accordingly, the deductions are held in trust in favour of the Commissioner of Inland Revenue ("the Commissioner") and are required to be paid to the Commissioner despite

liquidation occurring. However, where monies/deductions are not held on trust, the Commissioner will be subject to the priorities under schedule 7 of the Companies Act 1993 as a preferential creditor.

Facts

This was an appeal by the Commissioner against the decision of High Court Associate Judge Doogue. The High Court held that the Commissioner was not entitled to retain amounts paid to her by the Bank of New Zealand ("BNZ") pursuant to a deduction notice.

In the High Court, the Commissioner argued that the amounts deducted represented unpaid PAYE deductions and therefore were subject to a statutory trust in her favour under section 167(1) of the Act. The High Court held that the statutory trust under section 167(1) of the Act must come to an end on liquidation and this is made clear by section 167(2) of the Act (*Jennings Roadfreight Ltd (in liq) v Commissioner of Inland Revenue* [2012] NZHC 1441).

As at 15 March 2011, Jennings Roadfreight Limited ("Jennings") owed the Commissioner \$49,889.90 in PAYE for the month of February 2011. On the same day the Commissioner issued a notice pursuant to section 157 of the Act requiring BNZ to deduct funds from the respondent's bank account. The notice was issued in respect of goods and services tax (GST), not PAYE.

BNZ made various deductions from Jennings' bank account in accordance with the section 157 notice. The deductions totalled \$26,777.80. The Commissioner accepted that she was only entitled to retain the \$14,076.38 credit available in Jennings' bank account at the time the company went into liquidation and must account to the liquidators for the balance.

Decision

The majority (Wild and White JJ) held that the purpose of section 167(1) of the Act is to create a statutory trust, ensuring that any money in the trust remains outside the employer's estate on liquidation. The majority went on to specify that the trust fund would be a fluctuating credit balance of the employer's bank account. Further to this, the majority added that Jennings' liquidation did not extinguish the trust.

Wild and White JJ considered that the language of section 167(1) only made sense if the money is still held in the statutory trust created by section 167(1). Accordingly, Wild and White JJ considered Parliament's intent a critical point and specifically said that "Parliament would not have created the trust and provided for the exclusion of the trust money from the employer's estate upon liquidation if it had intended otherwise" (at [22]).

Section 167

The majority considered the application of sections 167(1) and (2) of the Act, finding that section 167(1) deals with the situation where the employer has dealt properly with the PAYE deduction(s), while section 167(2) deals with the situation where the employer has “failed” to deal properly with the “amount of the tax ... deducted ... in the manner required by section 167(1)”.

An employer will have failed to meet the requirements of section 167(1) if it no longer holds the PAYE it has deducted but not yet paid it to the Commissioner, in other words, if the employer has misapplied the monies held in trust for the Crown. Section 167(2) applies to PAYE deducted and neither paid by the employer to the Commissioner, nor held by the employer in its bank accounts available for payment to the Commissioner.

In respect of Jennings, the majority determined that section 167(1) of the Act applied to the \$14,076.38 in Jennings’ bank account when it was put into liquidation. The effect of section 167(1) being that the \$14,076.38 was held in trust for the Commissioner and “shall remain apart, and form no part of the estate in ... liquidation”.

The majority considered that section 167(2) applied to the \$35,813.52 difference between the \$49,889.90 Jennings had deducted and the \$14,076.38 Jennings held in its bank account at the time of liquidation. The effect of section 167(2) being that the Commissioner’s claim for that \$35,813.52 ranked under the schedule 7 priorities of the Companies Act 1993.

The majority went on to consider the legislative scheme, history and case law on sections 167(1) and (2) and concluded that these supported their interpretation of the sections. The majority therefore allowed the Commissioner’s appeal.

Ellen-France J dissented and referred to North P in *Westmoreland (Re Westmoreland Box Company Ltd (in liq), Crawshaw v Commissioner of Inland Revenue* [1968] NZLR 834 (CA) at 842.) in support of her view that the \$14,076.38 credited to the Commissioner by BNZ was not trust property.

INTENTION OR PURPOSE OF ONE OR MORE TRUSTEES ATTRIBUTABLE TO TRUST AS A WHOLE

Case	TRA 019/11
Decision date	30 September 2013 (released on 7 October 2013)
Act(s)	Income Tax Act 1994 and 2004, Tax Administration Act 1994, Goods and Services Tax Act 1985
Keywords	Intention or purpose of some of the trustees – whether amounts derived on disposal of properties are income, liability for GST – liability for shortfall penalties based on gross carelessness

Summary

The decision by the Taxation Review Authority (“TRA”) held that two of the three trustees, Mr and Mrs B, had the intention or purpose to sell when each of the relevant properties was acquired. This intention or purpose was attributable to the Trust as a whole, despite the third trustee asserting that she had no such purpose or intention. The TRA also held that the Trust’s activities amounted to a business of erecting buildings and a taxable activity for goods and services tax (“GST”) purposes. Accordingly, the trustees of the Trust were found to be jointly and severally liable to pay income tax and GST output tax on the sale proceeds from seven properties. The TRA also found that shortfall penalties for gross carelessness applied.

Impact of decision

The TRA’s decision that the intentions or purposes of some, but not all, of the trustees of a trust can be attributed to the Trust as a whole, is an important one. It appears to confirm the approach taken in *CIR v Boanas* (2008) 23 NZTC 22,046 (HC) in relation to the intentions of partners in a partnership. It is worth noting that the TRA also considered that from a broader perspective, it would result in “an extraordinary outcome if a trust can simply ignore the unanimous trustee requirement in its day to day operation and then be able to take advantage of that requirement when considering its tax obligations”. Such a comment also appears to echo the Court of Appeal’s sentiments in *Commissioner of Inland Revenue v Newmarket Trustees Ltd* [2012] NZCA 351; [2012] NZLR 207.

Facts

The disputants are the trustees of the B Family Trust (“the Trust”). The Trust was settled on 9 October 1996 by Mr and Mrs B, who were also appointed as trustees and were the

primary beneficiaries of the Trust. Mr and Mrs B's solicitor, Ms X, was also a professional trustee for the majority of the periods in dispute.

Over a 12-year period between September 1996 and September 2008, the Trust bought and sold 11 properties. Ten of those properties were purchased as vacant sections and the Trust had houses built on nine of those ten properties. Mr and Mrs B lived in each of the newly built houses for between two and ten months before selling them, with the exception of the tenth property, which they occupied for two and a half years.

Following an audit, the Commissioner issued default assessments to the Trust for income tax and GST on the sale proceeds from seven of the 11 properties. This was on the basis that:

1. the properties were bought with the purpose or intention of resale; and/or
2. the Trust was in the business of erecting buildings; and
3. the buying, improving, and selling of the seven properties constituted a taxable activity for GST purposes.

The Trust was also assessed for shortfall penalties on the basis that it had been grossly careless in taking its tax position or, alternatively, failed to take reasonable care.

The trustees disputed the Commissioner's assessments and filed a challenge proceeding in the TRA.

Decision

Attributing purpose or intention to the Trust

The disputant submitted that for the purposes of section CD 1(2)(a) of the Income Tax Act 1994 and 2004 ("the ITA"), the intention or purpose of sale must be attributable to the Trust as a whole, not just to individual trustees. Therefore, where intention or purpose is not unanimous, it cannot be regarded as an intention or purpose of the Trust. If just one of the trustees did not have the intention or purpose to sell when the relevant properties were acquired, it could not be concluded that the Trust as a whole had the intention or purpose to sell either. The disputant referred to the fact that the Deed of Trust required the decisions of the trustees to be made unanimously in support of this proposition.

The Commissioner contended that if Mr and Mrs B, acting in their capacities as trustees, had the intention or purpose of resale, the fact that Ms X may have had other intentions or purposes did not defeat the application of section CD 1(2)(a) of the ITA.

In finding for the Commissioner, the TRA agreed with the Commissioner's submission, that section CD 1(2)(a) of the ITA specifically provides that the intention or purpose to sell need only be one of a number of intentions and

purposes and does not need to be the dominant intention or purpose. The TRA also accepted the Commissioner's submission that it does not necessarily follow that Trustees had to be unanimous as to their intention for the future use of that land. There may be situations where trustees have different intentions. The TRA also considered that even if that approach was not correct, Ms X knew that Mr and Mrs B were entering into agreements for the sale and purchase of land. Ms X allowed her co-trustees to enter into these transactions and she was therefore estopped from denying that she approved the decisions of Mr and Mrs B. The Commissioner also contended that Mr and Mrs B were acting on behalf of the Trust when they purchased and sold Trust land and that it was clear from the evidence that Ms X was aware of her co-trustees' activities. As a consequence, all the trustees were bound by the decisions and actions of Mr and Mrs B.

The TRA concluded that in the circumstances, the intention of Mr and Mrs B could be attributed to the Trust.

Were the amounts derived on the disposal of the seven properties income?

Purpose or intention of sale

While the Commissioner contended that the Trust had acquired the relevant properties with the purpose or intention of sale, the Trust argued that when each of the relevant properties was acquired, the Trust had not intended to sell them. Instead, the Trust asserted that the intention was that each property would become Mr and Mrs B's long-term family home (as beneficiaries). Mr and Mrs B then gave evidence that shortly after each house was completed, unforeseen events occurred that required them to sell.

After considering the evidence, the TRA held that the Trust failed to prove on the balance of probability that, at the time of acquisition of each of the properties, the Trust did not have at least one intention or purpose of sale. The TRA found that Mr and Mrs B were not credible witnesses and that their alternative explanations for why each property had to be sold lacked credibility and were not supported by any contemporaneous documentation or evidence.

Business of erecting buildings

The Trust contended that it was not in the business of erecting buildings. This was on the basis that not only were the Trust's activities not carried out in a coherent and organised way, but that the Trust also lacked the necessary intention to make a profit. It was argued that the Trust did not have a coherent business plan nor did it maintain business records. In addition, it was argued that even if Mr and Mrs B had an intention to make a profit, that intention was not shared by Ms X and therefore the requisite intention to profit could not be attributed to the Trust as a whole.

Despite accepting that the Trust had not maintained business records, the TRA nonetheless held that the Trust's activities of purchasing sections, building houses and selling them on, were carried out in a coherent and organised way. For the reasons discussed earlier, the TRA disagreed with the Trust's "unanimous intention" argument, finding that the Trust as a whole had an intention to profit. For reasons covered in the TRA's analysis of the intention/ purpose/issue, the TRA also found that the relevant properties had been acquired for the purpose of the business of erecting buildings, and that in any case, the properties were disposed of within the applicable 10-year period after each house was completed.

Exemption for residential land

The TRA held that the "residential exemption" in section CD 1(3) of the ITA would only apply if a dwelling was used "primarily and principally" as a residence, and only if the taxpayer is not engaged in a regular pattern of acquiring and disposing or acquiring and erecting buildings (see *Case K21* (1988) 10 NZTC 218 (TRA); *Case M102* (1990) 12 NZTC 2,634 (TRA) and *Parry v Commissioner of Inland Revenue* (1984) 6 NZTC 61,820 (HC)).

The TRA agreed with the Commissioner's contention that the occupation of each property (with the exception of property five which was sold before being built on) was incidental to the more significant purpose of sale and as such the properties were not occupied "primarily or principally" as residences. The TRA also held that section CD 1(3) did not apply because the Trust was engaged in the acquisition of sections, construction of dwelling houses and subsequent sales to such an extent that a regular pattern of was established.

Is the Trust liable to account for GST output tax?

In line with the TRA's finding that the Trust was engaged in the business of erecting dwelling houses on the properties, the TRA also found that the Trust's activities of buying land, building houses and on-selling the developed properties constituted a taxable activity. As a consequence, the Trust was deemed to have been registered for GST and required to account for GST output tax on the sale proceeds from the properties.

The TRA did not accept the Trust's argument that the activities of buying, building and selling occurred simply as a series of "one off" transactions, and that the activities occurred on an intermittent basis.

Shortfall penalties

The TRA found that in view of the large number of sections that the Trust had purchased, improved and sold, there was a high risk of a tax shortfall occurring. The scale and duration of the activities undertaken by the trustees meant that the risk was an obvious and serious one. Because a

reasonable person in the circumstances of the trustees would have foreseen the risk, the TRA concluded that shortfall penalties for gross carelessness had to apply.

CHALLENGE OF COMMISSIONER'S ASSESSMENTS

Case	TRA 009/12
Decision date	23 October 2013
Act(s)	Income Tax Act 2004, Income Tax Act 2007
Keywords	Contractual interpretation

Summary

This was a capital/revenue case involving a sale and purchase of a shopping centre that was partially completed at the time of sale. The Commissioner of Inland Revenue ("the Commissioner") considered that the Sale and Purchase Agreement contained two separate agreements, one for the completed portion of the shopping centre (an undeveloped land) as at the time of the agreement, and the other for subsequent development of the undeveloped portion.

The Commissioner assessed the taxpayer on the basis that monies received for the subsequent development were revenue receipts and taxable income. The taxpayer ("the vendor") argued there was only one agreement and that all payments were capital receipts and not taxable. The Taxation Review Authority ("TRA") found for the taxpayer and cancelled the Commissioner's assessments.

Impact of decision

The TRA concluded, on the clauses contained in the relevant contract, that it is one agreement rather than two. The decision is confined to the clauses of this particular contract.

Facts

The taxpayer, incorporated in 1987, purchased a block of land in January 1988. The shares in the taxpayer were sold to Company P in 1996, and transferred to Company G as nominee in 1999. The land was to be developed into a shopping centre ("the Centre").

Before the development was complete, Company Y put forward a proposal to purchase the Centre "in its entirety". According to the proposal, the remaining development was to be undertaken on a "joint venture" basis.

Company Y and the taxpayer entered into an agreement for the sale and purchase of the Centre on 12 December 2003 ("the Agreement").

The taxpayer continued working on the development without any change in the plans or contractors, and found

tenants. The disputant obtained funding from Company Y to complete the development as it was going to be easier. Money was advanced on commercial terms with interest charged. The remaining development was completed over a period of five years.

Decision

In relation to interpreting the Agreement and admissibility of extrinsic evidence, Sinclair DCJ, after referring to *Commissioner of Inland Revenue v Renouf Corporation* (1998) 18 NZTC 13,914, and Justice Tipping's judgment in *Vector Gas v Bay of Plenty Energy Limited* [2010] 2 NZLR 444, held that she would not place any weight on the views of the parties as to their intentions in relation to the Agreement. Rather she focussed on the key clauses of the Agreement itself.

The Commissioner submitted that despite there being a measure of uncertainty in the recitals and definitions in the agreement, clause 4.1, which set out the purchase price, clarified that the Development Option was a separate agreement. The Commissioner argued that because the purchase price only took into account the price of the completed portion of the centre, and the land of the uncompleted portion, the further development was part of a separate agreement.

Sinclair DCJ held that this clause could not be looked at in isolation. She referred to other clauses within the agreement which she considered indicated it was one agreement for the sale of the completed shopping centre. In particular, she focussed on clauses 4.3 and 4.4 which provided a mechanism for the refunding of the purchase price paid in relation to any portion of the as yet undeveloped land, if that portion was unable to be developed into large format retailing. She concluded that these clauses clearly envisaged completion of the development, and were consistent with the taxpayer's position.

The main focus of the Commissioner's submissions was on the Development Option provided for in clause 15. The Commissioner argued that the option was independent of the sale of existing buildings and future development units ("FDUs"); that if the taxpayer did not take up the option under clause 15, it would not have been required to complete the development. Further, the Commissioner argued that the taxpayer was only obliged to use its best endeavours to develop the FDUs under the option.

Sinclair DCJ found that in fact there was no option to exercise as the taxpayer was already granted an option in consideration of the sum of \$1.00 already received and acknowledged by the purchaser under clause 15.1.

The Commissioner submitted that the Agreement does not provide any provision that will apply in case of a breach of the main Agreement or the Development Option. Sinclair DCJ referred to clause 16.4 where it requires the Vendor to indemnify the Purchaser against any loss or damage as a result of any breach of any term of the Agreement. Sinclair DCJ also noted that Company Y could still sue for breach of contract even if there was no specific provision in the Agreement.

The Commissioner argued that the parties were under a contractual obligation to enter into a construction contract under clauses 3.1 and 3.2 of the Sixth Schedule and this was an indication that the Development Option was a separate agreement. The Commissioner submitted that it showed the FDUs were intended to be developed under a contract for building services (within the wider Development Option) and this was inconsistent with the taxpayer's position that the contract was one agreement.

Sinclair DCJ, after referring to Justice Richardson's judgment in *Marac Life Assurance Limited v Commissioner of Inland Revenue and Ors; Commissioner of Inland Revenue and Ors v Marac Life Assurance Limited and Anor* (1986) 8 NZTC 5,086, did not consider that the parties intended to enter into a construction contract in the usual sense. It was only intended to detail the arrangement in the Development Option.

The TRA concluded that the parties entered into one agreement and therefore all payments received are of a capital nature and not assessable income under sections CB 1(1) or CB 3 of the Income Tax Act 2007. The Commissioner's assessments were cancelled.

TRINITY INVESTOR'S APPLICATION TO SET ASIDE THE COMMISSIONER'S STATUTORY DEMAND DISMISSED BY HIGH COURTS

Case	Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue [2013] NZCA 2818
Decision date	25 October 2013
Act(s)	Companies Act 1993, Tax Administration Act 1994
Keywords	Liquidation, recall, statutory demand

Summary

An application made by the plaintiff to set aside the Commissioner of Inland Revenue's ("the Commissioner")

statutory demand application. The plaintiff submitted that the amount claimed by the Commissioner was yet to be determined. The Court found that the amount owing had been determined in an earlier judgment and ordered the plaintiff to pay the sum of \$819,268.18 within 10 working days of this judgment.

Impact of decision

Pending challenges as to a loss attributing qualifying company's ("LAQC") shareholder's tax liability will not be sufficient ground to set aside a statutory demand requiring payment from the LAQC.

Facts

Redcliffe Forestry Venture Limited ("the plaintiff") applied for various orders relating to a statutory demand which was served. The statutory demand is sought by the Commissioner for the payment of \$819,268.18, made up of tax shortfall penalties and interest for the 1998 tax year arising from Redcliffe's involvement in the Trinity tax avoidance arrangement.

The Supreme Court in 2008 found the plaintiff liable for shortfall penalties (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [210]–[215]). The plaintiff was a party to the challenge to the Commissioner's assessment under Part 8A of the Tax Administration Act 1994 ("TAA") which was heard before Venning J as a hearing authority and subsequently upheld by the Court of Appeal (*Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230, (2007) 23 NZTC 21,323) and the Supreme Court (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*, [2008] NZSC 115, [2009] 2 NZLR 289).

Decision

Substantial dispute

The plaintiff submitted that the Commissioner's claim was a claim for a contingent or prospective composite sum, the amount of which was yet to be determined. It was submitted that the amount would not be known until the challenges made by the shareholders had been determined and that a separate calculation was required by virtue of section 141(3) of the TAA.

The Court determined that the calculation had already been undertaken and approved by the courts' decisions taken in their capacity as hearing authority and the subsequent appellate courts. Faire AJ concluded that there was no substantial dispute in that the plaintiff had failed to make out a case based on section 290(4)(a) of the Companies Act 1993. The debt is due.

Recall application

An application to the Supreme Court was made by the plaintiff after the hearing, to recall a paragraph (paragraph 214) of the Supreme Court judgment (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289). Faire AJ found that this application confuses the judgment on the one hand with the reasons for the judgment on the other. He found that the formal judgment is admissible evidence of the outcome of the case and that without recall of the formal judgment the result as pronounced by the Supreme Court stands.

Other grounds

The Court considered the decision in *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR (CA) 395 at [3] where it was observed that:

All cases involving s 290(4)(c) must in the end come down to a judgment by the Court as to whether the creditor's prima facie entitlement is outweighed by some factor or factors making it plainly unjust for liquidation to ensue.

Guidance was also given by the Court of Appeal in *AMC Construction Ltd v Frews Contracting Ltd* [2008] NZCA 389, (2008) 19 PRNZ 13 at [7] stating that:

... it is difficult to imagine circumstances in which the company should be able to avoid paying a debt, merely by proving that it is able to pay that debt. If the debt is indisputably owing, then it should be paid.

The Court considered the alternative ground referred to in the papers that relied on section 290(4)(c) of the Companies Act 1993. The argument was based on there being an abuse of process due to the fact that challenges to assessments that had been filed by the shareholders had not been concluded. Faire AJ concluded that that matter is no answer to the plaintiff's liability to the Commissioner, having regard to the Supreme Court's decision and that there were no proper grounds for applying section 290(4)(c) to this case.

Liquidation

In respect of immediate liquidation, both parties advised that they did not wish to contest the conclusions that were set out in [49] to [57] of the judgment in *Bristol Forestry Ventures Ltd* [2013] NZHC 2384 case. It was therefore concluded that it was not an appropriate case to order the immediate winding up of the company and the appointment of a liquidator.

The plaintiff was ordered to pay the sum of \$819,268.18 within 10 workings days of the judgment. In the event of default of payment, the Commissioner is permitted to make an application to put the plaintiff into liquidation.

APPLICATION TO STAY JUDGMENT PENDING APPEAL DISMISSED

Case	Bristol Forestry Venture Ltd and Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue
Decision date	25 October 2013
Act(s)	Companies Act 1993, Court of Appeal (Civil) Rules 2005 and Judicature Act 1908, schedule 2, High Court Rules
Keywords	Stay of proceeding, liquidation

Summary

The plaintiffs had previously unsuccessfully applied to have the Commissioner of Inland Revenue's ("the Commissioner") statutory demands set aside. This application was to stay the orders of the judgment of Faire AJ, pending the hearing and determination of an appeal. The plaintiff's application was refused.

Impact of decision

This judgment sets out the applicable law and the factors to be balanced when considering whether a stay of a proceeding should be ordered.

This judgment also confirms the position that due to the debt being owed and not paid within the ordered time frame of 10 working days by the plaintiffs, the Commissioner is entitled to make an application for the liquidation of the companies.

Facts

On 12 September 2013, Faire AJ declined the plaintiffs' application to set aside the statutory demands. Faire AJ ordered that the plaintiffs pay the sums claimed in the respective statutory demands and if they failed to make the required payments within ten (10) working days of the judgment, the Commissioner could make an application to put the companies into liquidation.

The plaintiffs have filed an appeal against the judgment of Faire AJ based on the grounds that one, the tax liability of the plaintiffs has not been finally determined as there is an outstanding application by the plaintiffs to set aside the 2004 Venning J decision *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027, and two, that the Commissioner is not a creditor.

The plaintiffs now apply for orders seeking to:

1. extend the time for payment until ten (10) working days after the Court of Appeal has delivered its decision; or alternatively

2. stay the orders of the judgment of Faire AJ, pending the hearing and determination of the appeal.

Decision

Extension of time pursuant to r 1.19 of the High Court Rules

The Court noted that this matter was considered by Bell AJ, who made an order on 31 May 2013 as follows:

I make an order under s 290(3) of the Companies Act 1993 extending the time for compliance with the statutory demands until a decision is given on the application under s 290 to set aside the statutory demands.

Faire AJ held that if the judgment of 12 September 2013 was to be stayed, pending the hearing of the appeal, the order made by Bell AJ would apply and time would be extended by his order without the need for the possible and questionable intervention of rule 1.19(2) of the High Court Rules.

Stay of the orders sought in reliance on r 12 of the Court of Appeal (Civil) Rules 2005

Faire AJ was required to balance the two principles set out in *Duncan v Osborne Building Ltd* (1992) 6 PRNZ 85 (CA) at [87], as well as consider the matters set out in *Keung v GBR Investment Ltd* [2010] NZCA 396, [2012] NZAR 17.

After considering these matters, Faire AJ found as follows:

1. The status of the plaintiffs will ultimately depend on whether an application to appoint a liquidator is filed and its outcome. The right of appeal will not be rendered nugatory by a refusal of a stay.
2. There is a risk of prejudice and injury to the Commissioner if the stay is granted; if the liquidation of the companies is the ultimate outcome, any delay will prejudice the remedies available to a liquidator and therefore the benefits that might accrue to creditors.
3. The public interest favours the refusal of a stay. Faire AJ made this conclusion after hearing the submissions of counsel for the Commissioner. The Commissioner submitted that there was a public interest in maintaining the integrity of the tax system, and in not allowing meritless litigation to consume public resources and delay the collection of tax that has been determined to be due after taxpayers have exhausted their challenge rights.
4. The plaintiffs have no intention of paying or providing security for the debt, despite the Supreme Court judgment. The balance of convenience favours a refusal of a stay in this case.

5. The debt arose following the upholding of decisions by the High Court, Court of Appeal and Supreme Court. The debt was accordingly due on the thirtieth day following completion of the final appeal in relation to the challenge to the assessment. This first ground of the plaintiffs' appeal is not soundly based.
6. The new ground sought to be introduced, that the Commissioner is not a creditor, is a novel argument. A final view on the issue is not expressed and the plaintiffs will need leave from the Court of Appeal to raise this further ground. This ground is not a significant factor in determining whether a stay should be granted in this case.

Faire AJ accordingly held that a stay, pending the appeal, should not be granted. The plaintiffs' application was refused and costs were reserved.

TAXPAYER'S SECTION 89M(11) APPLICATION DISMISSED

Case	Faloon v Commissioner of Inland Revenue
Decision date	10 October 2013
Act(s)	Tax Administration Act 1994
Keywords	Statement of Position, disputes resolution process, taxpayer-initiated dispute

Summary

The taxpayer applied to the High Court for leave to bring an Originating Application, for more time to reply to the Commissioner of Inland Revenue's ("the Commissioner") Statement of Position ("SOP") under section 89M(11) of the Tax Administration Act 1994 ("TAA"). The High Court declined the application. Ronald Young J agreed with the Commissioner's position that there was no right of reply to the Commissioner's SOP in a taxpayer-initiated dispute.

Impact of decision

This judgment confirms that section 89M(11) of the TAA does not allow a taxpayer a right of reply to the Commissioner's SOP in a taxpayer-initiated dispute.

Facts

Mr Faloon ("the taxpayer") filed two interlocutory applications. The first was an application for leave to bring an Originating Application (Rule 19.5 High Court Rules) pursuant to section 89M (11) of the TAA, for more time to reply to the Commissioner's SOP. The second was to set aside the Commissioner's Notice of Opposition and a supporting affidavit.

The taxpayer had filed income tax returns returning income that he believes he is entitled to. The taxpayer is of the view that he is due compensation for land that was compulsorily acquired from a company that his (now-deceased) father was shareholder and director of. The Commissioner reassessed the taxpayer without issuing a Notice of Proposed Adjustment ("NOPA") under 89C(f) of the TAA. The taxpayer then issued a NOPA and commenced the disputes resolution process. The Commissioner responded to the NOPA with a Notice of Response. The taxpayer then issued an SOP, which was followed by the Commissioner's SOP. The taxpayer then applied to the High Court for more time to reply to the Commissioner's SOP.

The taxpayer also applied to have the Commissioner's Notice of Opposition set aside on the basis that it did not comply with rule 5.44 of the High Court Rules (in that it did not include a memorandum setting out the name of the solicitor acting and address for service), and for the affidavit filed in support of the Commissioner's Notice of Opposition to be set aside on the basis that it contained statements that were inadmissible under the Evidence Act 2006.

Decision

Ronald Young J dismissed the taxpayer's applications. His Honour held that ordinarily, the Originating Application procedure would be suited to a section 89M(11) application. However, section 89M(11) of the TAA did not apply where a taxpayer had initiated the dispute process. His Honour agreed with the Commissioner's position that there was no right of reply to the Commissioner's SOP in a taxpayer-initiated dispute. His Honour stated it would be "a nonsense" to allow an application under section 89M(11) of the TAA when there was no right of reply to the Commissioner's SOP.

The Court also found that the technical failure of the Commissioner's Notice of Opposition was of no prejudice to the taxpayer and the non-compliance with the High Court Rules was of no lasting concern, therefore the Notice of Opposition should not be set aside. The Court further held that the statements in the Commissioner's supporting affidavit were not inadmissible as hearsay evidence (contrary to the Evidence Act 2006) because they were made in the context of the investigator providing her background knowledge into the taxpayer's affairs rather than being adduced to prove the truth of the statements.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Legal and Technical Services

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

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

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

Litigation Management

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

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