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TAX INFORMATION
Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED 0154	Draft depreciation determination – Machinery used for grading, sorting and packing produce	This draft determination proposes to set a provisional depreciation rate for machinery used for grading, sorting and packing food and agricultural products.	21 March 2013

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This determination sets the national standard costs for specified livestock for the 2012–2013 income year.

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The Plaintiff objected to the Commissioner of Inland Revenue's claim for increased costs for trial preparation and for disbursements, including expert witness fees, on the basis that the increased costs were significantly more than the "rule of thumb" (no more than 50% over the scale) and that the Commissioner's expert fees were excessive. The Court disagreed and upheld the majority of the Commissioner's claim for increased costs and allowed for full disbursements incurred by the Commissioner.

Taxation Review Authority grants an extension of time for service of points of objection notice 12

This Taxation Review Authority ("TRA") decision was concerned with whether extensions of time for service should be granted for Points of Objection Notices issued by a tax agent on behalf of three taxpayers. The Points of Objection Notices were received by the Commissioner of Inland Revenue outside the statutory time period prescribed by regulation 21(1) of the Taxation Review Authorities Regulations 1998. The TRA granted an extension of time for service to two of the taxpayers and declined the application of the third taxpayer.

BINDING RULINGS

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

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

FACTUAL REVIEW PROCESS

After consultation between Inland Revenue and interested taxpayer groups, a Factual Review process has been agreed and was implemented from 1 October 2012.

What is a Factual Review?

The Factual Review process has been established to enhance the utility of binding rulings in situations where a ruling is, or is likely to be, issued subject to a critical factual condition or assumption. The process will give taxpayers an opportunity to obtain a level of certainty from Inland Revenue regarding the likelihood that the condition or assumption will be satisfied.

Who may apply for a Factual Review?

Only taxpayers who have applied for a binding ruling may request a Factual Review. A Factual Review may be requested in writing at any time prior to or immediately following the issue of the ruling. In practice, such a request is likely to arise as a result of Inland Revenue's binding ruling team advising of the need for a critical condition or assumption to the ruling. However, it is possible that the need for such a condition or assumption may be identified as early as the pre-lodgement meeting. In those circumstances, the Factual Review may be carried out in parallel with the consideration of the binding ruling.

A Factual Review may be requested in relation to one or more critical factual conditions or assumptions in the ruling (eg, conditions or assumptions as to value, market rates or generally accepted accounting practice). However, to ensure that the Commissioner's limited resources are applied to the most appropriate and necessary cases, a Factual Review will only be undertaken in situations where Inland Revenue's Service Delivery Group is satisfied that:

- the factual condition or assumption is both potentially contentious and central to the efficacy of the ruling (eg, in situations where the arrangement may not proceed unless the condition or assumption can be satisfied); and
- Service Delivery has sufficient resources available to undertake the review.

In addition, the following will be accorded higher priority:

- prospective arrangements (ie, arrangements not yet entered into);
- arrangements of major commercial significance; and
- requests by taxpayers who have entered into a Cooperative Compliance Agreement with the Commissioner.

It is expected, given the requirement that the factual condition must be both contentious and central to the efficacy of the ruling, that the number of qualifying requests for Factual Reviews will be low.

If you wish to apply for a Factual Review this must be done in writing and sent to the following contact address:

Team Manager
Technical Services Unit
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

Phone: 04 890 6143

Email: **rulings@ird.govt.nz**

What happens when you request a Factual Review?

On receipt of a Factual Review request, Service Delivery will consider whether the eligibility criteria have been satisfied, and will notify the taxpayer accordingly.

Who is responsible for the Factual Review?

Responsibility and management of Factual Reviews will lie with the Investigations and Advice function of Service Delivery. The reviews will be undertaken by principal advisors and specialist staff with expertise in the relevant commercial matters (eg, valuation and financial modelling). Those staff members will typically not be part of the binding ruling team. If Inland Revenue does not retain expertise in a specific discipline, Service Delivery and the taxpayer may agree to engage independent external expertise (with the cost to be borne by the taxpayer).

Where a condition in a prospective arrangement relates to unknown future variables, the Factual Review will focus on the relevant methodology and/or accepted commercial principles.

Service Delivery will liaise with the binding ruling team in order to ensure consistency between the Factual Review and the binding ruling (particularly aspects of the arrangement and the terms of the relevant condition or assumption). If the binding ruling to which the Factual Review relates is withdrawn or the binding ruling team issues a final contrary view, the Factual Review process will end. If the binding ruling team issues an interim contrary view, the Factual Review process may be suspended.

Communication of the outcome of the Factual Review

The outcome of a Factual Review will be communicated by Service Delivery in writing as either a green (positive), amber (neutral) or red (contrary) letter, as follows:

- A green letter confirms that Inland Revenue considers that the relevant condition or assumption will be, or is likely to be, satisfied. However, the condition or assumption will not be removed from the binding ruling. Provided that the taxpayer does not deviate from the factual circumstances that exist when a green letter is issued, Inland Revenue will not seek to further test the condition or assumption by way of audit other than in exceptional circumstances.
- An amber letter indicates that Inland Revenue has not been able to conclude within the amount of time allocated to the Factual Review that the relevant condition or assumption will be, or is likely to be, satisfied. Inland Revenue will not necessarily seek to audit the taxpayer solely as a result of the issue of an amber letter. If the condition or assumption is subsequently tested during an audit, the taxpayer will have a further opportunity to engage with Service Delivery at that time.
- A red letter indicates that Inland Revenue considers that the relevant condition or assumption will not be, or is not likely to be, satisfied, and puts the taxpayer on notice that an audit is likely. If the Commissioner subsequently considers as a result of the audit that the condition or assumption is not satisfied, Inland Revenue will then treat the ruling as not applying (in accordance with the binding rulings legislation). It should be understood that even in cases where a red letter is issued, the Commissioner is still required to issue the associated binding ruling including the relevant condition or assumption, unless the ruling application is withdrawn.

The outcome of a Factual Review will not apply in the event of a material omission or misrepresentation relevant to the review. Similarly, the outcome of a Factual Review will cease to apply if the binding ruling to which it relates ceases to apply (eg, because of a material omission or other circumstance within ss 91EB or 91FB of the Tax Administration Act 1994).

What you need to know about Factual Reviews

What is the status of a Factual Review?

A Factual Review is carried out separately from the binding ruling process, and does not constitute an audit or investigation. Accordingly, the carrying out of a Factual Review will not affect the Commissioner's ability to make a binding ruling under s 91E (4)(g) of the Tax Administration Act 1994. Whilst a green letter is not legally binding on the Commissioner, it does constitute Inland Revenue's considered view regarding that issue, which will not be subsequently revisited and/or overturned other than in exceptional circumstances.

If a taxpayer disagrees with the outcome of a Factual Review, the matter can be taken up with Service Delivery if and when an audit is subsequently commenced. Further, the relevant condition or assumption can be tested through the disputes process in the usual manner.

The period of a Factual Review will match the period of the associated binding ruling.

How long will a Factual Review take?

A Factual Review is an opportunity for taxpayers to enter into a dialogue with Inland Revenue personnel with the relevant experience regarding the likelihood that a factual condition or assumption will be satisfied. Service Delivery will make personnel available for an appropriate amount of time within a 3-month period from the date the request is approved. It is envisaged that during this time there will be on-going discussion with the taxpayer.

It is hoped that within the allocated time agreement may be reached, or that Inland Revenue is able to reach a concluded view, but neither outcome is guaranteed or a requirement of this process. The 3-month period may be extended in exceptional circumstances, but this will be entirely at the Commissioner's discretion.

Once either an agreement or view is reached, or the amount of time allocated to the Factual Review has come to an end (if sooner), the outcome of the review will be communicated in writing to the taxpayer. Depending on the timing, this letter may accompany the draft or finalised binding ruling, or may be issued at a later date. Once the outcome of a Factual Review has been communicated with a taxpayer, no further correspondence will be entered into at that time.

The carrying out of a Factual Review will only affect the timing of the issue of the related draft or final ruling in exceptional circumstances (ie, the issue of a ruling, or completion of the ruling project, will generally not be deferred pending the outcome of the Factual Review).

Who bears the cost of the Factual Review?

There will be no charge made by Inland Revenue to the applicant for a Factual Review. Where Service Delivery and the taxpayer agree to engage independent external expertise, the cost will be borne by the taxpayer. In all cases, the taxpayer will be responsible for the costs of its own personnel and any advisers or experts used or consulted by it.

Information required for a Factual Review

The Factual Review will be based on information provided by the taxpayer for the purposes of the binding ruling application, together with:

- any relevant information supporting the factual position taken;
- any models/methodologies (ie, pricing methodologies, calculations, letters from experts); and
- any further information requested by Service Delivery.

Post-implementation review

The Factual Review process, the number of applications, its operation, and outcomes, will be reviewed after 1 year.

PRODUCT RULING BR PRD 12/09: ELECTRICITY AUTHORITY

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by the Electricity Authority.

Taxation Laws

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

This Ruling applies in respect of s EW 25B.

The Arrangement to which this Ruling applies

The Arrangement is the issue of option or obligation financial transmission rights (FTRs) by the Clearing Manager to participants. The FTRs are hedge products that allow an electricity trader to manage locational price risk that arises from variations in the wholesale spot prices between two points (eg, Benmore and Otahuhu) on the wholesale electricity grid.

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

Background

All references to the Electricity Industry Participation Code 2010 (Code) are to the Code as at the date of this Ruling.

1. Electricity generators compete in the electricity spot market to generate the electricity necessary to satisfy demand. The generators submit offers through a Wholesale Information and Trading System Manager (a contestable service, currently provided by the New Zealand Stock Exchange). The System Operator (Energy Market Services, a division of Transpower New Zealand Ltd) uses a scheduling, pricing and dispatch system to rank these offers, from which the half-hourly spot prices are derived for around 285 grid nodes. Retailers and some customers then buy electricity directly from the spot market at one of the grid exit points.
2. The amount paid for electricity by retailers and customers in the wholesale market always exceeds the payments made to the generators, due to losses and constraints in the system. The Clearing Manager accrues these surplus funds (referred to as the "loss and constraint excess") and allocates them to grid owners who in turn allocate them to transmission customers through a transmission pricing methodology. This allocation of surplus funds occurs on a monthly basis.

"Locational price risk"

3. Electricity generators may sell electricity to the market at the location where they generate electricity. Electricity retailers buy electricity on the wholesale market at points of connection on the grid where their customers are located. As most generators are also retailers, they sell electricity to the wholesale market at different locations from where they buy it.
4. Locational price risk arises in the electricity market from the unpredictable movements in the price for electricity at different grid nodes throughout New Zealand. Wholesale market prices are volatile and can rise quickly and sharply if certain events occur, such as when transmission cables or power stations are taken out of service (either for faults or maintenance).
5. The main source of locational price risk currently occurs between the North and South Islands (across the high voltage direct current link, which is the inter-island transmission link between Haywards near Wellington and Benmore). There can be large and volatile differences in wholesale market prices between the North and South Islands. Locational price risk can also occur between locations within each island.
6. An example of locational price risk occurs during dry winters, when low rainfall constrains electricity generation from hydro dams, most of which are located in the South Island. This means that large volumes of electricity have to be "imported" from the North Island, causing wholesale market prices in the South Island to rise above North Island prices.
7. Currently, generator-retailers minimise their locational price risk by seeking retail customers in regions close to where they have their generation assets. Retailers can arrange hedge contracts with generators or other market participants. However, they are still likely to be exposed to some locational price risk. Retailers could also seek an electricity contract for difference (CFD) with another party. However, they may continue to be exposed to locational price risk if the other party was subject to weak competitive pressure and could influence the price and undermine the benefit of the CFD. There may also be insufficient counterparties available because local generation in a region often accounts for only a portion of the load served—the rest is served from power imported over the transmission network.

Financial transmission rights

8. The Electricity Authority is required to address locational price risk under s 42 of the Electricity Industry Act 2010. In light of this, the Electricity Authority approved an amendment to the Code to introduce FTRs.

9. FTRs are a form of hedge product that allows an electricity trader to manage locational price risk arising from variations in wholesale spot prices between price points on the national grid. Initially, this will cover inter-island locational price risk between the Otahuhu and Benmore grid reference points. It is anticipated that this may be extended to include intra-island locational price risk.

10. The FTR market will consist of two types of FTRs:
    - Option FTRs will provide a payout only when the receiving end price exceeds the sending end price.
    - Obligation FTRs will provide a payout when the price at the receiving end of the FTR exceeds the sending end price, and will also require a payment to be made to the Clearing Manager when the opposite occurs.

11. Option FTRs will require a premium to be payable on entry into the FTR. This premium is to be determined by auction. However, the premium is not paid at the time of entry, but is to be settled at maturity. Option FTRs will provide the participant with a cap on the FTR reference price. The FTR reference price is the sum of certain differences in final prices for electricity between the relevant hubs over the relevant contract period. For example, assuming that the relevant hubs are the nodes at Benmore (sending end) and Otahuhu (receiving end):
    - If the final price at both Benmore and Otahuhu is $60 per megawatt hour (MWh), then the FTR reference price will be zero.
    - If the final price at Benmore is $40/MWh and the final price at Otahuhu is $100/MWh for every trading period in the contract period, then the FTR reference price will be $60/MWh multiplied by the number of trading periods in the contract period.
    - If the final price at Benmore is $100/MWh and the final price at Otahuhu is $40/MWh for every trading period in the contract period, then the FTR reference price will be zero (as the differences in final prices are all negative $60/MWh).

12. An obligation FTR has a two-way obligation to pay the difference between the FTR reference price and the initial price (or the price disclosed under clause 13.249(1)(b) of the Code if the FTR has been assigned) on settlement day. For an obligation FTR, the FTR reference price is the sum of all differences in final prices for electricity between the relevant hubs over the relevant contract period. Participants do not pay a premium for an obligation FTR. The initial price for the obligation FTR is determined at auction. Under the obligation FTR, if the FTR reference price exceeds the initial price (or the price disclosed under clause 13.249(1)(b) of the Code), the participant will receive the difference between the FTR reference price and the initial price (or the price disclosed under clause 13.249(1)(b)). However, if the initial price (or the price disclosed under clause 13.249(1)(b) of the Code), exceeds the FTR reference price, the participant must pay the difference.

13. The FTRs will be centrally funded from amounts accruing within the wholesale electricity market (loss and constraint excess) and auction premiums. FTRs will allow participants to manage their inter-island locational price risk, including that which arises from losses and constraints within the system. Ownership of an obligation FTR or option FTR does not entitle the participant to any rights for physical delivery of electricity.

14. Payments made under the FTRs to participants may be scaled in the event that there are insufficient funds. This may occur if events create a substantial difference between the notional grid used to determine the volume of FTRs issued, and the actual grid available in real time.

15. The key features of an FTR include:
    - Each FTR will have a calendar month duration and will be available in multiples of 0.1MW with a minimum quantity of 0.1MW.
    - FTRs will be available through monthly auctions at least 12 months in advance by the end of year 1; and at least 24 months in advance by the end of year 3.
    - Any premium payable on entry into an option FTR by market participants will be settled when the FTR matures.
    - On assignment, specific rules apply to impose an obligation on the assignee when the FTR matures. These rules may also impose an obligation on the assignor at the time of assignment or the Clearing Manager at the time the FTR matures.

- Payments to FTR holders will be funded by the loss and constraint excess as well as from FTR auction proceeds. It is intended that FTR payouts will reflect the full price difference between the Otahuhu and Benmore grid reference points. However, where revenue adequacy is not achieved, scaling of the FTR payout will occur.
- Any residual loss and constraint excess in the FTR account (that is, an amount remaining in the FTR account that relates to the relevant billing period and is not required to settle FTRs for that billing period) will be treated as loss and constraint excess, and will be paid to the grid owner for allocation to its transmission customers (as is the current position).
- A participant wishing to bid or trade FTRs will be required to post security. A participant may also be required to provide further security.

The Applicant

16. The Electricity Authority is an independent Crown entity responsible for the operation and regulation of the New Zealand electricity market. The Electricity Authority must pursue the statutory objective set out in the Electricity Industry Act 2010 to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

The participants

17. This Ruling only applies to participants who prepare accounts in accordance with International Financial Reporting Standards (IFRS).
18. The participants will include (but are not limited to) electricity generators and retailers. The parties who may apply to be an FTR participant are those who meet the following criteria:
    - Parties who meet the prudential requirements in relation to FTRs set out in Part 14 of the Code.
    - Parties who are within the category of persons to whom the FTR manager is authorised to issue FTRs. These are natural persons or a body corporate incorporated in New Zealand and is within one of the categories of "approved participant" in the Authorised Futures Dealers (Financial Transmission Rights) Notice 2012.
    - Parties who are registered by the Electricity Authority as an Industry Participant under s 9 of the Electricity Industry Act 2010 as a trader in electricity, and
    - Parties who agree to the standard FTR participation agreement.
19. The Authorised Futures Dealers (Financial Transmission Rights) Notice 2012 defines an "approved participant" as follows:
    (a) A person whose principal business is purchasing or selling electricity; or
    (b) A person who uses in excess of 10 GWh per annum of electricity; or
    (c) Her Majesty The Queen in right of New Zealand, a Crown entity named in the Crown Entities Act 2004, or a State enterprise named in the First or Second Schedule to the State-Owned Enterprises Act 1986 (each as amended from time to time); or
    (d) A member of the trade association known as the Major Electricity Users Group; or
    (e) A registered bank as defined in the Reserve Bank of New Zealand Act 1989; or
    (f) A person whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invests money; or
    (g) A person who is authorised to carry on the business of dealing in futures contracts under the Act; or
    (h) A person authorised in another jurisdiction by the competent authority of that jurisdiction to deal in futures contracts; or
    (i) A person that is a related body corporate of any of the persons listed in (a) to (h) above.
20. The participants may also be a party to ASX New Zealand electricity futures or options, electricity CFDs or other types of forward contract or other derivative instrument (Other Derivative Instruments).

The FTR Auction process

21. FTRs will be allocated to Participants by way of a monthly auction conducted by the FTR Manager.
22. The FTR Allocation Plan provides for a single-stage, sealed bid uniform price auction approach. This requires all bidders to submit bids for simultaneous assessment allowing optimisation of the allocation of FTRs amongst all the products on offer. All bidders will pay the FTR Auction Clearing Price (based on the lowest cleared bid) required to fill the allocation of FTRs across all FTR products for that FTR period.
23. The current proposal is for two sealed-bid auctions per month. The Primary Auction is where previously unlisted FTR periods are auctioned. For the primary auction, a proportion of FTR capacity will be offered. The Variation Auction is where additional FTRs for any of the previously listed FTR periods might be added.

24. The volume of FTRs to be issued will be based on the expected grid capacity at the time of auction or up to two years in advance. The actual grid capacity (in real time) might differ from the expected grid. To manage this, it is proposed that only a portion of the assessed FTR capacity will be issued in the Primary Auction, with subsequent Variation Auctions offering the majority of the remaining capacity.
25. It is also proposed that there will be Reconfiguration Auctions where FTRs may be sold back into Variation Auctions, facilitating secondary trading of FTRs. However, these may not be available from the outset and may require a Code amendment.

Assignments

26. Specific rules apply where FTRs are assigned from one party to another. The rules are outlined in clauses 13.248, 13.249 and 13.250 of the Code.
27. If the notification of assignment discloses the price at which the FTR has been assigned, the assignee becomes liable to pay that price to the Clearing Manager. Where the assignment price is less than the premium (for an option FTR) or the initial price (for an obligation FTR) or the previous price disclosed under clause 13.249(1)(b) of the Code if the FTR has previously been assigned, the assignor must pay the difference to the Clearing Manager at the time of assignment. If the assignment price is greater than the premium, initial price or the previous price disclosed under clause 13.249(1)(b) of the Code, the assignor is entitled to be paid the difference by the Clearing Manager when the FTR matures.
28. If the notification does not disclose the price at which the FTR has been assigned, the assignee is liable to pay the premium (for an option FTR) or the initial price (for an obligation FTR) or the previous price disclosed under clause 13.249(1)(b) of the Code (if the FTR has previously been assigned) to the Clearing Manager when the FTR matures.
29. It is expected that on-market secondary trading will eventually be permitted in FTRs.

This Ruling is made subject to the following conditions:

a) At all times, each participant will use the same spreading method for all FTRs held by them, unless a different accounting treatment under IFRSs is used.

b) During the period for which the Ruling applies, clause 2 of the FTR Allocation Plan will not be materially altered or amended from the FTR Allocation Plan approved on 29 June 2012 and provided to Inland Revenue on 12 October 2012.

How the Taxation Law applies to the Arrangement

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

a) The FTRs are not the "same as, or similar to" Other Derivative Instruments in terms of s EW 25B(1)(b). Therefore, s EW 25B will not require participants to use the same spreading method for FTRs as used for Other Derivative Instruments.

The period for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2013 and ending on 31 March 2017.

This Ruling is signed by me on the 13th day of December 2012.

Howard Davis
Director (Taxpayer Rulings)

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.

LIVESTOCK VALUES – 2013 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2012–2013 income year.

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

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

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

For bobby calves, information from spring 2012 is used while other dairy NSCs are based on survey data to 30 September 2012. For sheep, beef cattle, deer and goats, NSCs are based on survey data from the 2010–2011 year. This is the most recent information available for those livestock types at the time the NSCs are calculated in December 2012.

For the 2012–2013 income year there has been an increase in the NSCs for all livestock types except bobby calves. For sheep and beef cattle this reflects the increase, in real expenditure, of costs incurred per livestock unit. Also impacting on sheep and beef values were a decreased lambing percentage and a decrease in the supply of lambs, and a proportionally lower number of rising two-year beef cattle at open than for the previous year.

The increased NSCs for both rising one-year and rising two-year dairy cattle have come about largely because of an increase in costs per livestock unit, together with a higher proportion of rising one-year dairy cattle relative to the cows in milk. The decrease in NSC for purchased bobby calves largely results from cost decreases for foodstuffs.

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

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

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

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

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2013

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2013".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2012–2013 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007 the national standard costs for specified livestock for the 2012–2013 income year are as set out in the following table.

National standard costs for 2012–2013 income year

Kind of livestock	Category of livestock	National standard cost
Sheep	Rising 1 year	34.70
	Rising 2 year	22.60
Dairy cattle	Purchased bobby calves	171.40
	Rising 1 year	487.60
	Rising 2 year	119.20
Beef cattle	Rising 1 year	339.20
	Rising 2 year	190.10
	Rising 3 year male non-breeding cattle (all breeds)	190.10
Deer	Rising 1 year	114.80
	Rising 2 year	56.50
Goats (meat and fibre)	Rising 1 year	26.50
	Rising 2 year	18.20
Goats (dairy)	Rising 1 year	155.50
	Rising 2 year	26.40
Pigs	Weaners to 10 weeks of age	105.30
	Growing pigs 10 to 17 weeks of age	87.20

This determination is signed by me on the 30th day of January 2013.

Rob Wells
LTS Manager, Technical Standards

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.

GUIDELINE FOR AN INCREASE IN COSTS IS ONLY A GUIDELINE, NOT A RULE

Case	Sovereign Assurance Company Ltd and Others v Commissioner of Inland Revenue
Decision date	20 December 2012
Act(s)	Tax Administration Act 1994, High Court Rules
Keywords	Costs, trial preparation, reasonable in the circumstances, guideline or "rule of thumb"

Summary

The Plaintiff objected to the Commissioner of Inland Revenue's claim for increased costs for trial preparation and for disbursements, including expert witness fees, on the basis that the increased costs were significantly more than the "rule of thumb" (no more than 50% over the scale) and that the Commissioner's expert fees were excessive. The Court disagreed and upheld the majority of the Commissioner's claim for increased costs and allowed for full disbursements incurred by the Commissioner.

Impact of decision

This case is an example where, due to its complexity, the Court awarded increased costs.

Facts

On 4 October and 24 October 2012, the Commissioner filed memoranda to the Court regarding costs. The Commissioner claimed the sum of $383,082 for costs (this was an increase on scale costs) and $716,667.45 for disbursements. The Plaintiffs ("Sovereign") disputed the costs claimed by the Commissioner.

Decision

Costs

The main component of the Commissioner's cost claim that was disputed was for trial preparation. Band C of the High Court Rules' scale provides an allocation of 14 days for trial preparation. However, due to the nature of the case, the Commissioner claimed 60 days.

Costs for preparation of statements of defence and the first case management conference were also claimed by the Commissioner who sought:

1. band C in relation to the initial Statement of Defence;
2. band B in relation to subsequent substantive defences;
3. band A in relation to amended and consolidated defences; and
4. one day each for preparation of the case management conference.

Sovereign objected to the 60 days claimed and argued that the claim would be grossly in excess of the guideline or "rule of thumb" that increases are likely to be limited to 50%.

Furthermore, Sovereign calculated that the increase from 14 to 60 days would be a 429% increase and argued that it was beyond any comparable decisions.

Dobson J considered Sovereign's "rule of thumb" argument but took the same approach as France J in *New Zealand Fish & Game Council v Attorney-General* (2009) 20 PRNZ 557 (HC) at [15], that the 50% increase limit is only a guideline and not a rule. Accordingly, his Honour found that the case was vastly complex and granted an allowance of 50 days for trial preparation.

Dobson J upheld the Commissioner's claim in respect of the defences but agreed with Sovereign that costs relating to the case management conference preparation should be reduced from $2,940 to $1,176.

Disbursements

Sovereign objected to the Commissioner's claim of $514,057.80 for the four United Kingdom-based expert witnesses as being excessive. Rule 14.12(2)(d) of the High Court Rules was relied upon by Sovereign, arguing disbursements can only be awarded to the extent that they are reasonable in amount.

Sovereign also submitted that two of the four experts would be of little assistance to the Court and proposed that the Commissioner should be limited to a recovery of $70,000 per witness for the UK experts.

His Honour was satisfied that it was appropriate for the Commissioner to retain and call each of the experts due to the complexity of the case. Accordingly, Dobson J allowed the full extent claimed under disbursements.

TAXATION REVIEW AUTHORITY GRANTS AN EXTENSION OF TIME FOR SERVICE OF POINTS OF OBJECTION NOTICE

Case	TRA 27/08, 28/08 & 53/08; [2012] NZTRA 06
Decision date	23 August 2012
Act(s)	Taxation Review Authorities Regulations 1998, regulations 21(1), 23(a) and 25(1)
Keywords	Points of Objection Notices, exceptional circumstances, extension of time

Summary

This Taxation Review Authority ("TRA") decision was concerned with whether extensions of time for service should be granted for Points of Objection Notices issued by a tax agent on behalf of three taxpayers. The Points of Objection Notices were received by the Commissioner of Inland Revenue outside the statutory time period prescribed by regulation 21(1) of the Taxation Review Authorities Regulations 1998 ("TRA Regulations"). The TRA granted an extension of time for service to two of the taxpayers and declined the application of the third taxpayer.

Facts

The three taxpayers involved in this proceeding had sought cases stated to the TRA under the old objection procedure. In each of these cases the taxpayers failed to serve timely Points of Objection Notices upon the Director of Litigation Management. The taxpayers had also failed to seek an extension of time from the TRA to file their Points of Objection Notices. The Commissioner took this failure as a preliminary point and asked the TRA to dismiss the objections.

On 28 April 2011 an interim ruling *Case 9/2011* (2011) 25 NZTC 1-009 (TRA) was delivered by the TRA, on the issue of whether the three objectors should be granted an extension of time to file Point of Objection Notices on the grounds that "exceptional circumstances" under the TRA Regulations, regulation 25(2) existed.

In the interim ruling, the TRA found:

1. The Points of Objection Notices were not served in time, as the time for serving a Points of Objection Notice ran from the date the taxpayer gave notice that it wanted a case stated and not from receipt of Points of Objection Notices from the Commissioner.
2. The Taxation Review Authorities Act 1994 and Taxation Review Authorities Regulations 1998 did not require the Points of Objection Notices to be supplied by the Commissioner to the taxpayer.
3. While the Commissioner provided an incorrect date for service, this did not affect the outcome as the Points of Objection Notice was still supplied out of time.

In the interim ruling, Judge Barber reviewed the law addressing what constituted exceptional circumstances. While he accepted (at [64]) that it is regulation 23 of the TRA Regulations that must be complied with, he considered that the incorrect address on Inland Revenue's Points of Objection Notice form and advice as to the time period for filing the form may amount to exceptional circumstances.

The TRA directed that the hearing be reconvened as more evidence was required.

Decision

The TRA found as follows.

Taxpayer 1

The last day for Inland Revenue to receive the Points of Objection Notice was on 23 July 2008. The Points of Objection Notice was posted to the address on Inland Revenue's form supplied to the tax agent on 11 July 2008, but it was put by counsel for Inland Revenue that it was only received on 28 July 2008. Judge Barber stated that he had no reason to disbelieve the tax agent's evidence, and found that in the ordinary course of mail the Points of Objection Notice for taxpayer 1 must have been received by Inland Revenue well within time.

Taxpayer 2

The last day for Inland Revenue to receive the Points of Objection Notice seems to have been 16 July 2008. The tax agent stated that he posted the Points of Objection Notice on 15 July 2008, but it was only received by Inland Revenue on 18 July 2008. Judge Barber commented that in his experience of the ordinary course of New Zealand mail: "it is a little surprising that the Points of Objection Notice seems to have not been received by [Inland Revenue] on 16 July 2008". Judge Barber also considered that the arrangements for receipt of Points of Objection Notices by Inland Revenue were rather unsatisfactory and stated that he could not be sure that the Points of Objection Notice was not received until 18 July 2008.

Taxpayer 3

Judge Barber found that the Points of Objection Notice was posted well after the due date and that there seemed to be no meritorious explanation for the tax agent having got into that position.

Judge Barber noted his concern that the Points of Objection Notice forms supplied by Inland Revenue did not comply with the physical street address requirements in regulation 23 of the TRA Regulations. Judge Barber considered that if the Points of Objection Form had the correct physical address, then the tax agent may have arranged for personal service or couriering to that address. Further, Judge Barber considered that the tax agent could not have anticipated the confusion in arrangements for receipt of service of the Points of Objection Notices at Inland Revenue and that the tax agent appears to have complied with accepted standards of business organisation and professional conduct regarding the Points of Objections Notices for taxpayers 1 and 2.

Judge Barber held:

> It may be stretching the point to find that there was an event or circumstance beyond the control of the particular disputant which reasonably justifies not filing the Points of Objection Notice in time; but that event of circumstances was to leave matters to the tax agent JGR and I have covered the reasons for his predicament. [45]

The TRA granted the necessary extensions sought by taxpayer 1 and 2, but declined the application for taxpayer 3.

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Office of the Chief Tax Counsel

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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.

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