Vol 25 No 6 July 2013

TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

ISSN 0114–7161 (Print)
ISSN 1177–620X (Online)

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

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**

PRODUCT RULING BR PRD 13/02: UNIVERSITY OF CANTERBURY AND UNIVERSITY OF CANTERBURY FOUNDATION

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:

- University of Canterbury (University); and
- University of Canterbury Foundation (Foundation).

Taxation Laws

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

This Ruling applies in respect of:

- ss BG 1, CA 1(2), CC 3, CC 4, DB 41, EW 15, EW 31, GA 1 and LD 1, and the definition of "interest" in s YA 1;
- s 73 and the definition of "gift" in s 2 of the Estate and Gift Duties Act 1968.

The Arrangement to which this Ruling applies

The Arrangement is the raising of funds by the University for its capital works programme for the advancement of education and excellence at the University. The University has issued philanthropic bonds to the public, with university alumni being a focus of the offer.

The parties to the Arrangement are:

- the University, a tertiary education institution and registered charitable institution, as issuer;
- the Foundation, a registered charitable trust, as promoter;
- the Philanthropic Bond Trust (the Trust), a special purpose sub-trust fund the Foundation established to hold gifts of bond principal for special charitable purposes, being the capital works programme;
- bondholders.

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

Background

1. The University offered up to $50 million fixed rate unsubordinated unsecured bonds (the Bonds) (with the provision for a further $50 million for oversubscriptions). The Bonds are fully subscribed. Bonds are listed on the New Zealand Debt Market.
2. The Bonds are conventional bonds, in that the University will pay interest at a fixed rate and will be required to repay the principal after a fixed term. However, the Bonds also have novel features designed to encourage bondholders to make philanthropic gifts to the University. In particular:
    - Bondholders are invited to agree to receive bond interest at a rate of 0% per year for one or more interest periods (a Bond Interest Adjustment).
    - Bondholders are invited to request repayment of the Bond principal amount at any time during the term of a Bond for the sole purpose of making a cash donation to the Foundation (a Bond Principal Donation).
    - Bondholders are invited to agree to bequeath their Bonds to the Foundation in their will.
3. The material terms of the Arrangement are governed by the:
    - University of Canterbury Foundation Trust Deed dated 17 September 2001;
    - Registered Prospectus dated 5 October 2009;
    - Investment Statement dated 5 October 2009;
    - Trust Deed for the Issue of Bonds dated 5 October 2009 (Trust Deed);
    - Amended Trust Deed for the Issue of Bonds dated 29 November 2012 (Amended Trust Deed);
    - Memorandum of Understanding In Relation to Issue of Philanthropic Bonds and Supplemental Deed to Foundation Trust Deed dated 5 October 2009 (Memorandum of Understanding);

- First Amended Memorandum of Understanding In Relation to Issue of Philanthropic Bonds and Supplemental Deed to Foundation Trust Deed dated 18 October 2012 (Amended Memorandum of Understanding).

University of Canterbury

4. The University is a tertiary education institution established under the Education Act 1989 and University of Canterbury Act 1961. The University is also a charity, because its purposes relate to the advancement of education for the benefit of the general public. The University is registered as a charity with the Charities Commission in accordance with the Charities Act 2005.
5. The University's purposes are set out in the Education Act 1989. In particular:
   - the powers of the University's council can be exercised only to advance its charitable purposes (s 181 of the Education Act 1989 – Duties of Councils);
   - if the University is disestablished, its assets vest in the Minister of Education (s 217 of the Education Act 1989 – Effect of Disestablishment).

University of Canterbury Foundation and Philanthropic Bond Trust

6. The Foundation is a charitable trust established in 2001 to raise capital for the advancement of education at the University. The Foundation is registered as a board under the Charitable Trusts Act 1957 and registered as a charitable entity under the Charities Act 2005. The Foundation creates opportunities for supporters of the University and, in particular, alumni, to make gifts for the benefit of advancing education and excellence at the University. The Foundation also enables those gifted funds to be kept separate from the University's general operating budget. The Foundation's mission statement is:

   To support the University in its quest for excellence and international reputation in education and research by creating mutual benefit partnerships and opportunities for giving.

7. The Memorandum of Understanding between the University and the Foundation established the Trust fund for the benefit of the University. The Trust is a special purpose sub-trust of the Foundation. This sub-trust has its own trustees and is a separate trust fund, but the Registered Prospectus makes it clear that the Trust is and remains part of the Foundation.
8. The Trust will hold donated bond principal amounts and the asset and cash proceeds arising from repayment of the bond principal by the University. The establishment of the Trust ensures the benefits resulting from Bond Principal Donations can be separately identified (from the other funds of the Foundation) and used for certain special purposes stated in the Memorandum of Understanding. Those special purposes, as the trustees decide, are the advancing and promoting of the capital works programme, namely for the construction, acquisition and provision of buildings, plant, equipment, libraries, texts, learning and research tools and capital facilities for the University. These special purposes are charitable because they are for the advancement of education.
9. Clause 6.4 of the Memorandum of Understanding prohibits the trustees of the Trust from paying any part of the Bond Principal Donations to the University for unrestricted application to the general purposes of the University. Accordingly, the Trust funds are to be applied exclusively for charitable purposes. If, for some reason, the Trust funds cannot be applied to the special purposes, they must still be used in accordance with the objects of the Foundation.
10. The Foundation's objects are exclusively charitable, and limited to New Zealand (cls 4 and 5 of the Trust Deed of the University of Canterbury Foundation). Clauses 10 and 11 of the Foundation's trust deed also prohibit any individual from benefiting or profiting from the trust or trust fund and require that trust funds be applied only to charitable purposes if the Foundation is wound up or dissolved. Further, the Foundation's rules cannot be amended if it would cause the board to be declared non-charitable (cl 10 of Schedule 2 of the Foundation's trust deed).

Bonds

11. The University is the issuer of the Bonds. The Bonds are 10-year fixed rate, unsubordinated, unsecured bonds. The offer period for subscribing for the bonds was from 9 October 2009 to 30 November 2009. Over this period, bondholders subscribed for 50,010,000 Bonds at an issue price of $1 per bond. A total of $50,010,000 was raised.
12. The Bonds were issued on 7 December 2009 pursuant to the Trust Deed, and currently pay a coupon of 7.25% per year fixed for five years. The coupon payable on the Bonds is reset after five years at 1.75% above the then-prevailing five-year swap rate. Interest is paid six monthly in arrears on each interest payment date (being 15 June and 15 December of each year). The first interest payment date is 15 June 2010. The Bonds mature on 15 December 2019.

13. The Bonds have been amended in accordance with the Amended Trust Deed and the Amended Memorandum of Understanding.

Bond Interest Adjustment

14. Under the terms of the Bond, a bondholder may give notice to the Bond registrar that they agree to a Bond Interest Adjustment. As a result of the bondholder giving notice, the interest rate payable by the University to the bondholder is agreed to be 0% per annum, effective from the first day of the interest period (provided notice of the agreement is received on or before the record date for the interest period).

15. The Bond Interest Adjustment continues until the bondholder withdraws agreement or the Bond is transferred. Bond Interest Adjustments must be made in minimum parcels of 1,000 Bonds and in multiples of 1,000. By making a Bond Interest Adjustment, a bondholder is effectively donating the foregone interest to the University.

Bond Principal Donation

16. Under the terms of the Bond, a bondholder may give notice to the registrar that they wish to make a Bond Principal Donation.

17. To enable bond principal only to be gifted, the Bonds allow for early repayment of the bond principal for the sole purpose of making a cash donation to the Foundation. Despite the repayment and gifting of the principal, the bondholder maintains their right to interest. The Trust Deed provides that on the bond donation date the:
    - University will repay the bond principal (or may pay the bond principal directly to the Foundation on behalf of the bondholder);
    - bond registrar will record in the register that the bond principal amount has been repaid and that the bondholder continues to be entitled to receive interest on the Bonds up until, but excluding, the maturity date; and
    - terms and conditions of the Bonds otherwise remain unchanged.

18. The bondholder may specify a bond donation date, being any date between the date that is 15 business days after the registrar's receipt of the bond donation notice and the bond's maturity date. However, if during any rolling 12-month period the University receives bond donation requests totalling more than $2 million (or such other amount as is notified by the University from time to time), the University may at its discretion defer any excess requests for a period of 12 months and 10 working days, and that deferred date will become the bond donation date.

19. Gifting of the principal when there is continuing liability for the University to pay interest, will be available exclusively for gifts to the Foundation. Bond Principal Donations must be made in minimum parcels of 1,000 Bonds and in multiples of 1,000.

Donation of Bond on Death

20. Bondholders may contract with the University to bequeath (by their will) their Bonds to the Foundation on the event of their death. Bondholders exercise this option by completing the appropriate form.

21. The form will constitute a contract for valuable consideration between the bondholder and the University that is enforceable by the Foundation. Under the contract, the bondholder agrees to bequeath their Bonds to the Foundation in the bondholder's will. This election may be revoked in writing to the University at any time before the bondholder's death. On the death of the bondholder, the Bond will be registered in the name of the Foundation and the interest rate will be adjusted to nil.

How the Taxation Laws apply to the Arrangement

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

- Bondholders who make a Bond Interest Adjustment:
  - (i) will not derive, by reason of that Bond Interest Adjustment, any "interest" income as defined in s YA 1, income arising under the financial arrangement rules, or income under ordinary concepts in respect of those interest periods under ss CA 1(2), CC 3 and CC 4;
  - (ii) will not be entitled to a refundable tax credit under s LD 1 or a deduction under s DB 41 in any income year; and
  - (iii) will be exempt from gift duty under s 73 of the Estate and Gift Duties Act 1968, if by reason of that Bond Interest Adjustment there is a "gift" as defined by s 2 of that Act.
- Bondholders who make a Bond Principal Donation:
  - (i) will not derive any income or expenditure under the financial arrangement rules under ss EW 15 and EW 31 from the bond principal being repaid for the purpose of making a cash donation to the Foundation, provided the relevant Bonds were acquired for an amount equal to their issue price;
  - (ii) will be entitled to a refundable tax credit under s LD 1 in the income year in which the Bond Principal

Donation date falls for the full cash amount of bond principal being repaid and donated, provided they are not an excluded person under s LD 2 and provided the requirements of s 41A of the Tax Administration Act 1994 are met;

(iii) will be entitled to a deduction under s DB 41 in the income year in which the Bond Principal Donation date falls, for the cash amount of the bond principal being repaid and donated, if the bondholder is a company, subject to the limitation on the amount of the deduction to the company's net income for the income year in s DB 41(3) and subject to the application of any general limitation in s DA 2; and

(iv) will be exempt from gift duty under s 73 of the Estate and Gift Duties Act 1968 on any gift made as a result of donating the bond principal repaid.

- Bondholders may contract with the University to bequeath their Bonds to the Foundation in their will. The act of entering into that contract:
  (i) will not generate taxable income in the hands of the bondholder under s CA 1; and
  (ii) will not give rise to a dutiable gift under s 63 of the Estate and Gift Duties Act 1968.
- Sections BG 1 and GA 1 of the Act do not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 December 2009 and ending on 31 December 2014.

This Ruling is signed by me on the 8th day of April 2013.

Fiona Heiford
Director (Taxpayer Rulings)

PRODUCT RULING BR PRD 13/03: REACH MEDIA – DISTRIBUTORS

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Law

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

This Ruling applies in respect of:

- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Act;
- section DA 2(4) of the Act; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("the GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of persons ("Distributors") by Reach Media to physically deliver unaddressed mail (newspapers, circulars, leaflets, brochures, catalogues, advertising material, samples and other such items) from drop-off locations to households and other premises throughout New Zealand.

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

1. The Parties to the Arrangement are:
   (a) Reach Media: a New Zealand incorporated company that is currently owned equally by New Zealand Post Limited and Salmat International Pty Limited, and which carries on the business of delivering unaddressed mail to New Zealand households.
   (b) Distributors: persons who physically deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand.
2. Although not technically parties to the Arrangement, Reach Media also contracts with:
   (a) Supervisors: persons who are or are to be contracted by Reach Media to provide certain supervisory services in metropolitan or rural areas in relation to the delivery of unaddressed mail.
   (b) Drivers: persons who use their own vehicles to transport the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations.
3. The Distributors will not be carrying any item which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.
4. Reach Media is currently run by a management team based in Auckland with processing branches throughout the country. Unaddressed mail is delivered by a network of Distributors, Drivers and Supervisors.
5. Reach Media's processes and systems are aligned with industry practice. The industry uses a delivery model of supervisors who co-ordinate the activities of a team of distributors. The Drivers, Distributors and Supervisors are paid on a "piece rate" basis under contracts for services (ie, as independent contractors).
6. The Distributors are engaged under a standard form contract—Contract for Services – Distribution Contractor, to physically deliver unaddressed Mail from the drop-off locations to households and other premises throughout New Zealand ("the Contract").
7. There are two versions of the Contract. Most of the Distributors are currently engaged under the earlier version—("Version 1 Contract"). Reach Media is in the process of introducing the later version—("Version 2 Contract") for newly-engaged Distributors.
8. There is no material difference between the two versions of the Contract. The changes reflected in the Version 2 Contract were made to improve the simplicity and readability of the Contract, and to shift non-material content to an online Operational Manual which the Distributors are instructed to also consult. There is therefore no material difference between the Version 2 Contract and the Version 1 Contract on which the previous Product ruling – BR Prd 09/05 is based.
9. Specific procedural details referred to in both versions of the Contract are also provided in specific Delivery Instructions given to the Distributors before each Job ("the Delivery Instructions").
10. The key changes reflected in the Version 2 Contract are:
    - the inclusion of reference to the Operational Manual;
    - the removal of the Delivery Guidelines from Schedule 2 of the Version 1 Contract to the first part of Section 1 of the Operational Manual;
    - the removal of the list of important things that Distributors should do and should not do when carrying out their obligations under the Contract

from Schedule 3 of the Version 1 Contract to the second part of Section 1 of the Manual;

- the removal of the competition section from the body of the Contract and transferring it to section 2 of the Operational Manual;
- some alteration to the way piece rates are calculated in schedule 2 of the Version 2 Contract;
- the removal of Schedule 4 (the dispute resolution flowchart) and Schedule 5 (the geographic map).

11. The Operational Manual does not replace or override any of the material terms of the Contract, and it does not affect the nature of the contractual relationship between Reach Media and the Distributors.

12. The terms of the Contract under various headings are as follows.

13. Under the heading "Deliveries", the Contract states the Distributor agrees to:

- deliver all product (papers/circulars) received by the Distributor from Reach Media to the letter boxes in the Distributor's Round within the timeframes ("the Delivery Window") communicated by Reach Media on the Delivery Instructions (exactly when each Distributor completes the deliveries within the delivery window is at the Distributor's discretion)
- make all deliveries in accordance with the delivery Guidelines in Schedule 2 (which may be amended by Reach Media from time to time) (Version 1 Contract)
- make all deliveries in accordance with the delivery Guidelines in the Manual (which may be amended by Reach Media from time to time) (Version 2 Contract)
- ensure other commitments do not affect the Distributor's obligations to Reach Media
- comply with tax and health and safety legislation (Version 1 Contract)
- familiarise himself or herself with, and fully comply with, the Operational Manual (and any amendments) and any applicable legislation including that related to tax and health and safety (Version 2 Contract).

14. Under the heading "Payment" the fees are the only amounts payable in respect of the services and are inclusive of all taxes (except GST) and other duties and levies. Each Distributor's fee for undertaking the services for Reach Media is calculated under schedule 2 at a rate determined by the volume of deliveries. Under version 2 of the Contract, Payment is made by direct credit fortnightly and on a Thursday. Under Version 1 Contract payment is made on the 2nd and 7th of each month. Reach Media will provide a buyer created invoice to Distributors within 7 days of payment. The implication of these provisions is that Reach Media will provide an invoice to Distributors (which takes the form of a buyer created tax invoice for GST-registered Distributors or a similar invoice for Distributors who are not GST-registered) prior to payment, with payment made on a fortnightly basis.

15. Schedule 1 of the Contract requires Distributors to provide their personal, bank and Inland Revenue details.

16. Under the heading "Delivery Equipment", the Contract states that the Distributors are responsible for providing their own equipment (such as personal office supplies, a telephone, a vehicle and wet weather gear) at their own expense. The Distributors are also responsible for ensuring that such equipment is well maintained, safe and fit for its purpose.

17. Under the heading "Taxation", the Contract specifies that the Distributors are responsible for the payment of their own taxes, duties and levies (including income tax, GST and Accident Compensation levies if applicable), and any other income related payments or deductions that may be legislated from time to time. The Distributors will register for GST with Inland Revenue if required to do so, and will advise Reach Media that they are GST registered. Reach Media will then provide them with a buyer created tax invoice and they must not send a GST tax invoice to Reach Media.

18. Under the heading "Termination of Contract", the Contract states that Reach Media or the Distributors may terminate the contract for any reasons whatsoever by giving two weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice. Under the Version 2 Contract Reach Media may also terminate the Contract for serious breach of the Manual (and any amendments).

19. Under the heading "Status of Contractor", the Contract defines the contractor's status as follows:

- Reach Media engages each Distributor under a contract for services, so the Distributor is an independent contractor; the terms of the Contract or its operation do not create an employment relationship between the Distributor and Reach Media. (These statements in the Contract are referred to in the Ruling as the "Clarification Statements". They are not considered to be material for the purposes of the conditions that the ruling is subject to).

- The Distributor may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.

20. Under the heading "Liability",
    - The Version 1 Contract states that the Distributor is to undertake the services at their own risk. This means Reach Media will not be liable to the Distributor (or any other person) for any loss resulting from the Distributor's deliberate actions or negligence or where there is a breach of any term of this contract.
    - The Version 2 Contract states that the Distributor is to undertake the services at their own risk. This means Reach Media will not be liable to the Distributor (or any other person) for any loss resulting from the Distributor's deliberate actions or negligence or where there is a breach of any term of this contract or the Manual (and any amendments).
21. Under the heading "Delivery Options", the Contracts state that the Distributor is responsible for arranging for someone else to carry out the Distributor's services if the Distributor is unable to work. The Distributor is solely responsible for payment and all other obligations to others who help them in this way.
22. Under the heading "Frequency of Deliveries", the Contract states that Reach Media does not guarantee any minimum amount of Deliveries as the volume of product available for distribution will vary depending on the time of year and the requirements of Reach Media's clients.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The terms of the Contract entered into between Reach Media and the Distributors are the same as those contained in the Version 1 Contract and Version 2 Contract provided to the Inland Revenue Department in the Ruling Application dated 26 November 2012, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses that are contained in the Online Operational Manual or specific Delivery instructions; and

b) The relationship between Reach Media and any of the Distributors is, and during the period of this Ruling will apply, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any of the conditions stated above, the Taxation Laws apply to the Arrangement as follows:

a) For the purposes of the PAYE rules, any payment made to a Distributor by Reach Media under the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in ss RD 5, RD 7 and RD 8 respectively of the Act.

b) For the purpose of section DA 2(4), any payment made to a Distributor by Reach Media under the Contract will not be "income from employment".

c) For the purposes of the GST Act, the provision of services by any Distributor under the Contract will not be excluded from the definition of "taxable activity" (as defined in section 6 of that Act) by section 6(3)(b) of that Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2012 and ending on 30 June 2016.

This Ruling is signed by me on the 29th day of April 2013.

Maryanne Hansen
Investigation Manager, Investigations and Advice

PRODUCT RULING BR PRD 13/04 – DRIVERS

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Law

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

This Ruling applies in respect of:

- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Act;
- section DA 2(4) of the Act; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("the GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of persons ("Drivers") by Reach Media to transport unaddressed mail (newspapers, circulars, leaflets, brochures, catalogues, advertising material, samples and other such items) from Reach Media's premises to a number of pre-determined drop-off locations.

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

1. The Parties to the Arrangement are:
   (a) Reach Media: a New Zealand incorporated company that is currently owned equally by New Zealand Post Limited and Salmat International Pty Limited, and which carries on the business of delivering unaddressed mail to New Zealand households.
   (b) Drivers: persons who use their own vehicles to transport the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations.
2. Although not technically parties to the Arrangement, Reach Media also contracts with:
   (a) Distributors: persons who physically deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand.
   (b) Supervisors: persons who are or are to be contracted by Reach Media to provide certain supervisory services in metropolitan or rural areas in relation to the delivery of unaddressed mail.
3. The Drivers will not be carrying any item which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.
4. Reach Media is currently run by a management team based in Auckland with processing branches throughout the country. Unaddressed mail is delivered by a network of Distributors, Drivers and Supervisors.
5. Reach Media's processes and systems are aligned with industry practice. The industry uses a delivery model of supervisors who co-ordinate the activities of a team of distributors. The Drivers, Distributors and Supervisors are paid on a "piece rate" basis under contracts for services (ie, as independent contractors).
6. The Drivers are engaged under a standard form contract—Contract for Services to Perform Driver Delivery Services of Papers and Circulars or Contract for Services to Perform Driver Delivery Services of Unaddressed Mail ("the Contract").
7. There are two versions of the Contract. Most of the Drivers are currently engaged under the earlier version—Contract for Services to Perform Driver Delivery Services of Papers and Circulars ("Version 1 Contract"). Reach Media is in the process of introducing the later version—Contract for Services to Perform Driver Delivery Services of Unaddressed Mail ("Version 2 Contract") for newly-engaged Drivers.
8. There is no material difference between the two versions of the Contract. The changes reflected in the Version 2 Contract were made to improve the simplicity and readability of the Contract, and to shift non-material content to an online Operational Manual which the Drivers are instructed to also consult. There is therefore no material difference between the Version 2 Contract and the Version 1 Contract on which the previous Product ruling – BR Prd 09/03 is based.
9. Specific procedural details referred to in both versions of the Contract are also provided in specific Delivery Instructions given to the Drivers before each Job ("the Delivery Instructions").
10. The key changes reflected in the Version 2 Contract are:
    - the inclusion of reference to the Operational Manual;
    - the inclusion of the Vehicle section, defining more clearly Driver's obligations for vehicle safety and obtaining insurance;
    - the removal of the competition section from the body of the Contract and transferring it to section 2 of the Operational Manual;

- some alteration to the way piece rates are calculated in schedule 2 of the Version 2 Contract;
- the removal of Schedule 3 (the geographic map), Schedule 4 (the template tax invoice) and schedule 5 (the dispute resolution flowchart) as included in the Version 1 Contract; and
- the renumbering of the Driver details form as schedule 3 of the version 2 Contract (previously this was Schedule 6 of the Version 1 Contract.

11. The Operational Manual does not replace or override any of the material terms of the Contract, and it does not affect the nature of the contractual relationship between Reach Media and the Drivers.
12. The terms of the Contract under various headings are as follows.
13. Under the heading "Services", the Contract requires the Drivers to:
    - complete the services set out in Schedule 1 of the Contract;
    - ensure other business commitments do not affect their obligations to Reach Media; and
    - comply with tax and health and safety legislation (Version 1 Contract);
    - familiarise themselves with, and fully comply with, the Operational Manual (and any amendments) and any applicable legislation including that related to tax and health and safety (Version 2 Contract).
14. Schedule 1 of the Contract requires Drivers to collect particular items within a specified period from Reach Media's premises and transport those items to pre-determined drop-off locations.
15. Schedule 1 specifies the services for which the Drivers are contracted:
    - The Driver is engaged to deliver the delivery material to the contracted distributors in a defined area and complete related tasks.
    - The services Drivers are to perform are the collection of stock, physical delivery of individual items, and physical return of surplus stock.
16. Under the heading "Equipment", the Contract states that the Drivers are responsible for providing their own equipment (such as personal office supplies, a telephone, a vehicle and wet weather gear) at their own expense. The Drivers are also responsible for ensuring that such equipment is well maintained, safe and fit for its purpose.
17. Under the heading "Vehicle" (Version 2 Contract), each Driver's obligations for vehicle safety and obtaining insurance are defined more clearly.
18. Under the heading "Payment", the fees are the only amounts payable in respect of the services and are inclusive of all taxes (except GST) and other duties and levies. Each Driver's fee for undertaking the services for Reach Media is calculated under Schedule 2 at a rate determined by the volume of deliveries. The Version 1 Contract specifies that Reach Media will provide a draft invoice to Drivers twice a month, and that an example of the invoice is at schedule 4. The Version 2 Contract specifies that Reach Media will provide a "buyer created tax invoice" to the Drivers. The Drivers must check the invoice and advise Reach Media of any errors. Payment is made by direct credit within seven days. The implication of these provisions is that Reach Media will provide an invoice to Drivers (which takes the form of a buyer created tax invoice for GST-registered Drivers or a similar invoice for Drivers who are not GST-registered) prior to payment, with payment made on a fortnightly basis.
19. Under the heading "Taxation", the Contract states that the Drivers will register for GST with Inland Revenue if required to do so. It provides the current registration threshold. The Version 2 Contract specifies that the Drivers are responsible for the payment of their own taxes on payments made to them by Reach Media under the Contract; that Reach Media may be required to withhold taxes from its payments; and if so, the payment made will be reduced to the extent that tax is withheld.
20. Under the heading "Termination of Contract", the Contract states that Reach Media or the Drivers may terminate the contract for any reasons whatsoever by giving four weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice. Under the Version 2 Contract Reach Media may also terminate the Contract for serious breach of the Operational Manual (and any amendments).
21. Under the heading "Status of Contractor", the Contract defines the contractor's status as follows:
    - Reach Media engages each Driver under a contract for services, so the Driver is an independent contractor; the terms of the Contract or its operation do not create an employment relationship between the Driver and Reach Media. (These statements in the Contract are referred to in this Ruling as the "Clarification Statements". They are not considered to be material for the purposes of the conditions that the Ruling is subject to).

- The Driver may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.

22. Under the heading "No Liability",
    - The Version 1 Contract states that the Driver is to undertake the services at their own risk. This means Reach Media will not be liable to the Driver (or any other person) for any loss resulting from the Driver's deliberate actions or negligence or where there is a breach of any term of this contract.
    - The Version 2 Contract states that the Driver is to undertake the services at their own risk. This means Reach Media will not be liable to the Driver (or any other person) for any loss resulting from the Driver's deliberate actions or negligence or where there is a breach of any term of this contract or the Operational Manual (and any amendments). The Driver agree to indemnify Reach Media against any direct, indirect or consequential injury, loss or damage that Reach Media may suffer as a result of any breach by the Driver, of the Contract or arising out of an act, default or omission, or any representation made by the Driver. This indemnity will continue to apply after termination of the Contract.
23. Under the heading "Delivery Options", the Contract states that the Driver is responsible for arranging for someone else to carry out the services if the Driver is unable to work. The Driver is solely responsible for payment and all other obligations to others who help him or her in this way.
24. Under the heading "Frequency of Deliveries", the Contract states that Reach Media does not guarantee any minimum amount of material for which the Driver will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The terms of the Contract entered into between Reach Media and the Drivers are the same as those contained in the Version 1 Contract or Version 2 Contract provided to the Inland Revenue Department in the Ruling Application dated 26 November 2012, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses that are contained in the Online Operational Manual or specific Delivery instructions; and

b) The relationship between Reach Media and any of the Drivers is, and during the period of this Ruling will apply, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any of the conditions stated above, the Taxation Laws apply to the Arrangement as follows:

a) For the purposes of the PAYE rules, any payment made to a Driver by Reach Media under the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in ss RD 5, RD 7 and RD 8 respectively of the Act.

b) For the purpose of section DA 2(4), any payment made to a Driver by Reach Media under the Contract will not be "income from employment".

c) For the purposes of the GST Act, the provision of services by any Driver under the Contract will not be excluded from the definition of "taxable activity" (as defined in section 6 of that Act) by section 6(3)(b) of that Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2012 and ending on 30 June 2016.

This Ruling is signed by me on the 29th day of April 2013.

Maryanne Hansen
Investigation Manager, Investigations and Advice

PRODUCT RULING BR PRD 13/05: REACH MEDIA – SUPERVISORS

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 Reach Media New Zealand Limited ("Reach Media").

Taxation Law

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

This Ruling applies in respect of:

- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Act;
- section DA 2(4) of the Act; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 ("the GST Act").

The Arrangement to which this Ruling applies

The Arrangement is the engagement of persons ("Supervisors"), by Reach Media to provide certain supervisory services in metropolitan and rural areas in relation to the delivery of newspapers, circulars, leaflets, brochures, catalogues, advertising material, samples and other such items.

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

1. The Parties to the Arrangement are:
   (a) Reach Media: a New Zealand incorporated company that is currently owned equally by New Zealand Post Limited and Salmat International Pty Limited, and which carries on the business of delivering unaddressed mail to New Zealand households.
   (b) Supervisors: persons who are or are to be contracted by Reach Media to provide certain supervisory services in metropolitan or rural areas in relation to the delivery of unaddressed mail.
2. Although not technically parties to the Arrangement, Reach Media also contracts with:
   (a) Distributors: persons who physically deliver the unaddressed mail from the drop-off locations to households and other premises throughout New Zealand.
   (b) Drivers: persons who use their own vehicles to transport the unaddressed mail from Reach Media's premises to a series of pre-determined drop-off locations.
3. The items deliveries that are supervised by the Supervisors are not items the carriage of which requires Reach Media to be registered as a postal operator under the Postal Services Act 1998, and Reach Media will not register as such.
4. Reach Media is currently run by a management team based in Auckland with processing branches throughout the country. Unaddressed mail is delivered by a network of Distributors, Drivers and Supervisors.
5. Reach Media's processes and systems are aligned with industry practice. The industry uses a delivery model of supervisors who co-ordinate the activities of a team of distributors. The Drivers, Distributors and Supervisors are paid on a "piece rate" basis under contracts for services (ie, as independent contractors).
6. The Supervisors are engaged under a standard form contract—Contract for Services to Supervise Delivery of Papers and Circulars (in metro or rural areas), or Contract for Services to Supervise Delivery of Unaddressed Mail ("the Contract").
7. There are two versions of the Contract. Most of the Supervisors are currently engaged under the earlier version—Contract for Services to Supervise Delivery of Papers and Circulars – Metro, or Contract for Services to Supervise Delivery of Papers and Circulars – Country ("Version 1 Contracts"). Reach Media is in the process of introducing the later version—Contract for Services to Supervise Delivery of Unaddressed Mail ("Version 2 Contract) for newly-engaged Supervisors.
8. The two contracts in the Version 1 Contracts are virtually identical. The only difference is that the services to be provided by a rural Supervisor under schedule 1 include (under the heading "Processing Stock"), the preparation and distribution of unaddressed mail to Distributors operating under the rural Supervisor. Schedule 1 for metro supervisors does not include this service. This difference is reflected in schedule 1 of the Version 2 Contract where the Processing Stock service is to be deleted for metro supervisors. The Version 2 Contract is in essence a single contract for both metro and rural Supervisors. There is no material difference between the two versions of the Contract. The changes reflected in the Version 2 Contract were made to improve the simplicity and readability of the Contract, and to shift non-material content to an online Operational Manual which the Supervisors are instructed to also consult.

There is therefore no material difference between the Version 2 Contract and the Version 1 Contracts on which the previous Product Rulings – BR Prd 09/04 and BR Prd 09/06 are based.

9. Specific procedural details referred to in both versions of the Contract are also provided in specific Delivery Instructions given to the Supervisors before each Job ("the Delivery Instructions").
10. The key changes reflected in the Version 2 Contract are:
    - the inclusion of reference to the Operational Manual;
    - the removal of the competition section from the body of the Contract and transferring it to section 2 of the Operational Manual;
    - some alteration to the way piece rates are calculated in schedule 2 of the Version 2 Contract;
    - the removal of Schedule 3 (the geographic map), Schedule 4 (the template tax invoice) and schedule 5 (the dispute resolution flowchart) as included in the Version 1 Contracts; and
    - the renumbering of the Supervisor details form as schedule 3 of the Version 2 Contract (previously this was Schedule 6 of the Version 1 Contract).
11. The Operational Manual does not replace or override any of the material terms of the Contract, and it does not affect the nature of the contractual relationship between Reach Media and the Supervisors.
12. The terms of the Contract under various headings are as follows.
13. Under the heading "Services", the Contract requires the Supervisors to:
    - complete the services set out in Schedule 1 of the Contract;
    - ensure other business commitments do not affect their obligations to Reach Media;
    - comply with tax and health and safety legislation (Version 1 Contracts);
    - familiarise themselves with, and fully comply with, the Operational Manual (and any amendments) and any applicable legislation including that related to tax and health and safety (Version 2 Contract).
14. Schedule 1 of the Contract requires Supervisors to oversee the delivery of material by Contracted Distributors in a defined area and to complete related tasks.
15. Schedule 1 specifies the services for which the Supervisors are contracted:
    - Processing Stock: preparation and distribution of stock to each Contracted Distributor within the Supervisor's area (this requirement is deleted for metro Supervisors).
    - Physical Delivery: overseeing of the physical delivery of the individual items by the Contracted Distributors to nominated delivery points.
    - Administration: maintain and supply to Reach Media details of current Contracted Distributors and provide information in relation to any Round changes and associated delivery quantities including No Circular counts.
    - Client Service: ensure delivery contractors phone or text in conformation of delivery before the close of the Delivery Window.
16. Under the heading "Payment" the fees are the only amounts payable in respect of the Deliveries and are inclusive of all taxes (except GST) and other duties and levies. Each Supervisor's fee for performing the Services for Reach Media is calculated at the rates set out in schedule 2. Under Version 1 Contracts Reach Media will provide a draft monthly invoice twice a month for contracted deliveries to Supervisors and make payment by direct credit within 7 days. Under Version 2 Contract Reach Media will provide a "buyer created tax invoice" prior to payment and will make payment by direct credit fortnightly on a Thursday. The implication of these provisions is that Reach Media will provide an invoice to Supervisors (which takes the form of a buyer created tax invoice for GST-registered Supervisors or a similar invoice for Supervisors who are not GST-registered) prior to payment, with payment made on a fortnightly basis.
17. Under the heading "Equipment", the Contract states that the Supervisors are responsible for providing their own equipment (such as personal office supplies, a telephone, a vehicle and wet weather gear) at their own expense. The Supervisors are also responsible for ensuring that such equipment is well maintained, safe and fit for its purpose.
18. Under the heading "Taxation", the Contract states that the Supervisors will register for GST with Inland Revenue if required to do so. It provides the current registration threshold. The Contract specifies that the Supervisors are responsible for the payment of their own taxes on payments made to them by Reach Media under the Contract; that Reach Media may be required to withhold taxes from its payments; and if so, the payment made will be reduced to the extent that tax is withheld.

19. Under the heading "Termination of Contract", the Contract states that Reach Media or the Supervisors may terminate the contract for any reasons whatsoever by giving four weeks' notice in writing. However, if Reach Media believes there has been a serious breach of the Contract, then Reach Media may terminate the Contract immediately without notice. Under the Version 2 Contract Reach Media may also terminate the Contract for serious breach of the Manual (and any amendments).
20. Under the heading "Status of Contractor", the Contract defines the contractor's status as follows:
    - Reach Media engages each Supervisor under a contract for services, so the Supervisor is an independent contractor; the terms of the Contract or its operation do not create an employment relationship between the Supervisor and Reach Media. (These statements in the Contracts are referred to in this Ruling as the "Clarification Statements". They are not considered to be material for the purposes of the conditions that the Ruling is subject to).
    - The Supervisor may accept other engagements or work while engaged by Reach Media unless there is a conflict of interest.
21. Under the heading "Indemnity",
    - The Version 1 Contracts state that the Supervisor is to undertake the services at their own risk. This means Reach Media will not be liable to the Supervisor (or any other person) for any loss resulting from the Supervisor's deliberate actions or negligence or where there is a breach of any term of this contract.
    - The Version 2 Contract states that the Supervisor is to undertake the services at their own risk. This means Reach Media will not be liable to the Supervisor (or any other person) for any loss resulting from the Supervisor's deliberate actions or negligence or where there is a breach of any term of this contract or the Manual (and any amendments).
22. Under the heading "Delivery Options", the Contract states that the Supervisor is responsible for arranging for someone else to carry out the services if the Supervisor is unable to work. The Supervisor is solely responsible for payment and all other obligations to others who help them in this way.
23. Under the heading "Frequency of Deliveries", the Contract states that Reach Media does not guarantee any minimum amount of material for which the Supervisor will carry out the services.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

e) The terms of the Contract entered into between Reach Media and the Supervisors are the same as those contained in the Version 1 Contracts and Version 2 Contract provided to the Inland Revenue Department in the Ruling Application dated 26 November 2012, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses that are contained in the Online Operational Manual or specific Delivery instructions; and

f) The relationship between Reach Media and any of the Supervisors is, and during the period of this Ruling will apply, in accordance with all of the material terms of the Contract.

For the avoidance of doubt, the Clarification Statements are not considered to be material for the purposes of these conditions.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any of the conditions stated above, the Taxation Laws apply to the Arrangement as follows:

g) For the purposes of the PAYE rules, any payment made to a Supervisor by Reach Media under the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in ss RD 5, RD 7 and RD 8 respectively of the Act.

h) For the purpose of section DA 2(4), any payment made to a Supervisor by Reach Media under the Contract will not be "income from employment".

i) For the purposes of the GST Act, the provision of services by any Supervisor under "the Contract" will not be excluded from the definition of "taxable activity" (as defined in section 6 of that Act) by section 6(3)(b) of that Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 July 2012 and ending on 30 June 2016.

This Ruling is signed by me on the 29th day of April 2013.

Maryanne Hansen
Investigation Manager, Investigations and Advice

PRODUCT RULING BR PRD 13/06: NEW ZEALAND BLOODSTOCK LEASING LIMITED

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 New Zealand Bloodstock Leasing Limited (NZBL).

Taxation Laws

All legislative references are to the Income Tax Act 2007.

This Ruling applies in respect of ss BD 4(2), BG 1, DA 1(1), DA 2, EA 3, EC 38 to EC 48, EJ 10, FA 6 to FA 12 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of a thoroughbred breed of horse (bloodstock) on the terms provided in the Bloodstock Lease to Purchase Agreement (Bloodstock Agreement) entered into by NZBL and its customers for customers to use in breeding bloodstock progeny.

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

Purpose of the Arrangement

1. NZBL, New Zealand Bloodstock Limited (NZB), New Zealand Bloodstock Finance Limited (NZB Finance) and New Zealand Bloodstock Progeny Limited (NZB Progeny) are all 100% owned subsidiaries of New Zealand Bloodstock Holdings Limited (NZB Holdings). Together they are referred to in this ruling as the "NZB Group".
2. NZB Holdings established NZBL to expand its business and increase sales of bloodstock in New Zealand by making investment in the bloodstock industry more attractive to existing and new entrants. The availability of leasing reduces the initial level of cash required by existing and new entrants to the bloodstock business to acquire bloodstock. The leasing arrangement gives the customers the opportunity to participate in the business of breeding bloodstock by leasing the bloodstock. NZB is contractually entitled to provide the auctioning services for any progeny of the bloodstock. The benefit for the NZB Group from the leasing arrangement is that NZB gets the commissions from selling the bloodstock and the commissions from any sale of progeny from the bloodstock, in addition to NZBL's right to receive the lease payments.

Sourcing of the bloodstock

3. NZBL acquires new bloodstock from third party owners, and then leases this bloodstock to the customer. Alternatively, the customer purchases the new bloodstock from the third party owner, sells it to NZBL, and then leases the bloodstock from NZBL. This helps to protect NZBL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases, the parties contemplate the transaction as a whole at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.
4. NZBL may also acquire bloodstock that is already owned by the customer, either through an earlier purchase or because it is homebred (the already owned bloodstock) and the proceeds or sale of the already owned bloodstock are only used for the further investment in the customer's bloodstock breeding business.
5. It is agreed in the Bloodstock Agreement that the customer may purchase the bloodstock at the end of the lease. The Bloodstock Agreement describes the Arrangement:

   WHEREAS

   A. The Lessee has requested the Lessor to purchase the Animal described in the Schedule hereto (hereinafter called 'the Animal') and upon purchase thereof to lease and, if required, to re-sell the Animal to the Lessee in accordance with the terms hereof.

   B. The Lessor has purchased the Animal and has agreed to lease the Animal to the Lessee and the Lessee has agreed to lease the Animal with the right to purchase it upon the terms and conditions more particularly outlined herein.

   C. The Animal secures the payment or performance of the Lessee's obligations hereunder and this Agreement creates a security interest in the Animal in terms of the Personal Property Securities Act 1999.

   D. The Lessor has agreed to this Lease to Purchase Agreement for the specific purpose of assisting the Lessee in the business of breeding bloodstock for sale by adding to its inventory and upon the basis that the Lessee, if it wishes to sell the leased animal or, if a mare, the progeny thereof, will sell the same through the bloodstock auctions conducted by its parent company New Zealand Bloodstock Limited.

   E. The Lessee has entered into this agreement for the purpose of obtaining breeding stock to use in the Lessee's business of bloodstock breeding for sale.

Lease particulars

6. The terms and duration of leases are based on individual requirements, credit risk, and potential breeding expectations. Lease periods may vary, but a typical lease term is three years for fillies or mares, and two years for colts or stallions.

Lease Assignment

7. When the lease is executed, in some instances NZBL may assign the lease to NZB Finance for the discounted value of the cash flow. The discount is equivalent to the market rate offered by third party companies providing such financing facilities. The assignment is on a non-recourse basis, and NZBL is not liable to NZB Finance in the event of default by the lessee.

8. The Notice of Assignment describes this assignment as:

> TAKE NOTICE that on the New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows
>
> (a) To New Zealand Bloodstock Finance Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the leasing of the Animal under the said Agreement and without limiting the generality of the foregoing all of the rights of the Lessor to receive payments of rental as and when they shall become due or other monies payable under the said Agreement by the Lessee to the Lessor or in respect of the Lessor enforcing such rights and receiving such payments as are prescribed by the said Agreement.
>
> You are directed to pay all payments of rental due under the said Agreement and all other payments due in respect of the lease of the Animal therein described to the said New Zealand Bloodstock Finance Limited and in future to deal with that company in respect of all matters pertaining to the leasing arrangement under the said Agreement.

Residual Value

9. The bloodstock has a defined Residual Value under the Bloodstock Agreement. The Residual Value is an estimate (at the time of signing the lease) of the value the bloodstock will have at the end of the lease. "Residual Value" is defined in the Bloodstock Agreement as:

> 'Residual value' means the amount specified in the Schedule hereto as such being a pre-estimate of the value of the Animal upon the expiry of this Lease.

Bloodstock Assignment

10. After the lease has been entered into and assigned to NZB Finance, NZBL may assign the title to the bloodstock to NZB Progeny. Because the Residual Value, if realised at all, is not realised by NZB Progeny until the end of the lease, NZB Progeny pays to NZBL the discounted value of the residual value payment. The discounted value is calculated using market rates materially the same as those used by third party companies providing financial facilities.

11. Transferring the bloodstock titles to NZB Progeny gives additional asset protection benefit to the NZB Group. In this way the group's interest in the bloodstock is separated and protected from the day to day business activities of NZB, NZB Finance and NZBL. The Notice of Assignment from NZBL to the lessee describes this assignment as:

> TAKE NOTICE that on the New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows
>
> (a)…
>
> (b) To New Zealand Bloodstock Progeny Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the title to and property in the Animal and the right to receive payment of the Residual value outlined in the said Agreement and any other monies due under the said Agreement in respect of the title to or ownership of the Animal.
>
> You are directed to pay the amount of Residual Value of the Animal on the date payable under the said Agreement to New Zealand Bloodstock Progeny Limited and in future to deal with that company in respect of all matters relating to the ownership and wellbeing of the Animal(s).

Lease Termination Date

12. The "Lease Termination Date" is the date on which the lease ends. The customer may purchase the bloodstock on the Lease Termination Date for the Residual Value. If the customer does exercise their option to purchase the bloodstock, NZB Progeny or NZBL will transfer title to the customer in return for payment of the Residual Value.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The customer is in the business, as defined in s YA 1, of breeding bloodstock.

b) Where the bloodstock is already owned bloodstock, the customers will enter into the Bloodstock Agreement for one or both of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:

- The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business, and/or
- The need for certainty of cash inflows for further investment in the customer's bloodstock breeding business through the sale of the bloodstock to NZBL.

c) Where the bloodstock is new bloodstock, the customers will enter into the Bloodstock Agreement for one or a number of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:
- The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business
- The need for certainty of cash outflows through structuring the lease payments, and/or
- The need to reduce the initial level of cash required to enter the bloodstock breeding business or to purchase new bloodstock.

d) The customer has not entered into two or more consecutive or successive leases (within the meaning of paragraph (d)(iv) of the "lease" definition in s YA 1, if the reference to "the same personal property lease asset" is read as a reference to "the same bloodstock") of the same bloodstock.

e) The customer has entered into the Bloodstock Agreement for the sole purpose of breeding from the leased bloodstock and intends to use the leased bloodstock in deriving assessable income.

f) The lease payments are genuine, arm's length amounts for the possession and use of the bloodstock.

g) The leased bloodstock is mature for use in breeding and is capable of being used for breeding at all times during the period to which each lease payment relates.

h) Any racing undertaken by the leased bloodstock is incidental to the actual use of the bloodstock for breeding during the lease term.

i) The Residual Value of the bloodstock is a reasonable, and the parties' best, estimate of the likely market value of the bloodstock at the Lease Termination Date.

j) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.

k) No consideration is paid for the option to purchase the bloodstock at the Lease Termination Date.

l) The customer is not in the business, as defined in s YA 1, of selling or exchanging leases.

m) At the time of entering into the Bloodstock Agreement, the customer does not intend to dispose of the lease.

n) The customer is not carrying on or carrying out an undertaking or scheme of trading leases entered into or devised for the purpose of making a profit.

How the Taxation Laws apply to the Arrangement

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

a) The bloodstock lease payments are deductible under s DA 1(1) and none of the general limitations in s DA 2 apply, provided that:

   (i) no provision in subparts DB to DZ applies to prevent a deduction in section DA 1(1), and

   (ii) the income arising from the Arrangement is derived by the customer in New Zealand.

b) At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, s EA 3 applies to require the unexpired portion of any lease payments paid in advance to be included in the customer's income in the current income year and to be an amount for which the customer is allowed a deduction in the following income year.

c) The valuation and specified write-down provisions in ss EC 38 to EC 48 apply to the customer when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date.

d) The "cost price" of the bloodstock for the purposes of ss EC 38 to EC 48 is the Residual Value stated in the Bloodstock Agreement.

e) The financial arrangements rules in subpart EW do not apply to the Arrangement.

f) Section EJ 10 does not apply to the Arrangement as the lease is not an operating lease.

g) Sections FA 6 to FA 11 do not apply to the Arrangement as the lease is not a finance lease.

h) Section FA 12 does not apply to the Arrangement as the lease is not a hire purchase agreement.

i) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 6 December 2012 and ending on 6 December 2017.

This Ruling is signed by me on the 6th day of May 2013.

Chris Springett
Investigation Manager, Investigations and Advice

PRODUCT RULING BR PRD 13/07: MINISTRY OF BUSINESS, INNOVATION AND EMPLOYMENT

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 Ministry of Business, Innovation and Employment (MBIE).

Taxation Laws

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

This Ruling applies in respect of ss 5 and 8 and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the charging of an annual levy (Levy) on liable telecommunication operators by the Minister of the Crown (Minister) for the time being responsible for the administration of the Telecommunications Act 2001 (Telecommunications Act) under the Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2011 (2011 Levy Regulations). The Arrangement ensures the cost the Commerce Commission (Commission) incurs in regulating telecommunications operators is paid, in part, by telecommunications operators.

The Levy is collected by MBIE (the Ministry responsible for administering the Telecommunications Act for the Minister).

The Commission is a Crown entity listed in sch 1 pt 3 of the Crown Entities Act 2004, it is resident in New Zealand for GST purposes and is a "registered person" as that term is defined in s 2(1).

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

Background

1. In March 2000 a Ministerial inquiry into telecommunications was established to assess the regulatory regime for telecommunications and recommend any changes. Following the inquiry, the Government announced it was establishing a new regulatory framework for the telecommunications industry that would include the establishment of a Telecommunications Commissioner in the Commission. A levy imposed on the telecommunications industry would meet the general costs of the Commission (including the Telecommunications Commissioner) incurred in carrying out its telecommunications-specific regulatory functions.

2. In May 2001, the Telecommunications Bill 2001 (2001 Bill) was introduced into Parliament and referred to the Commerce Select Committee for consideration. The Explanatory Note to the 2001 Bill relevantly stated that:

> Thirdly, the position of a new specialist Telecommunications Commissioner is established within the Commission. The Telecommunications Commissioner's main functions will be to–
>
> - make determinations on disputes over designated services and specified services in accordance with the processes set out in *Part 2*; and
> - report to the responsible Minister on the desirability of regulating additional services in accordance with a process contained in *Schedule 3*; and
> - undertake key costing and monitoring activities under *Part 3* relating to telecommunications service obligations.
>
> …
>
> *Subpart 2* deals with preliminary matters about the Commission, which will have an important role in the context of designated services and specified services (*Part 2*) and telecommunications service obligations (*Part 3*).
>
> In particular, *subpart 2*–
>
> - provides for the appointment of a specialist Telecommunications Commissioner as a member of the Commission (clause 9):
> - specifies when the Telecommunications Commissioner will be involved in performing the functions of the Commission under this Bill, and specifies the number of other members of the Commission who will be involved in performing those functions (clause 10):
> - specifies the provisions of the Commerce Act 1986 that apply to the Bill:
> - provides that the Commission's costs in performing its functions under the Bill will be met by prescribing levies payable by prescribed telecommunications providers.

3. The Commentary to the 2001 Bill, as reported back from the Commerce Committee, stated that the Telecommunications Commissioner's funding "is based on an industry levy". The Commentary to the 2001 Bill relevantly stated:

> **Industry levy**
>
> The committee agrees it is appropriate that the Commerce Commission's new functions be funded by an annual levy on telecommunications

> services providers, in accordance with regulations. The committee notes that dispute resolution (determinations) will be paid for by the parties to the dispute.
>
> To ensure a smooth transition to the new system, government member's recommend the annual levy be raised retrospectively in its first year, to cover establishment costs. Government and Green members also recommend the Minister be required to consult with the industry prior to setting a levy.
>
> …
>
> **Accountability arrangements**
>
> The Telecommunications Commissioner will be funded from Vote Communications and there will be a Memorandum of Understanding between the Ministry of Economic Development and the Commerce Commission covering this and other outputs the ministry is funding. The Minister of Communications had indicated that he expects the Commission to consult with industry in setting its telecommunications budget. The Government's position is that the budget process and the Commission's annual report to Parliament will be expected to keep the Telecommunications Commissioner's costs under control. It is also expected that the Commission will consult directly with industry on its work plan and budget to help address any industry concerns.

4. The Telecommunications Act was enacted on 19 December 2001. The industry levy was imposed by the *Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2002* (2002 Levy Regulations) with application from the financial year commencing 1 July 2001. Essentially, the 2002 Levy Regulations provided for the Telecommunications Commissioner's annual estimated costs to be met by telecommunications operators. The costs were apportioned by reference to each operator's annual revenues attributable to services offered by means of a "public switched telephone network" (PSTN) as that term is defined in the Telecommunications Act. Once the Telecommunications Commissioner's actual costs were identified in the Commission's annual audited financial statements, under-payments had to be met by each telecommunications operator and over-payments were repaid.

5. Following a stocktake of the New Zealand telecommunications industry, the Government introduced the Telecommunications Amendment Bill 2006 (2006 Bill). The 2006 Bill contained additional regulatory functions and powers to be performed by the Commission. It also enhanced the ability of the Commission to intervene to best promote the development of competition in telecommunications markets. The amendments in the 2006 Bill included:
   - introducing a standard terms determination process that would allow the Commission to simultaneously set access terms and conditions for regulated services for multiple access seekers, access providers or both
   - providing for a formal undertakings process that allowed the Commission to accept and enforce voluntary supply commitments from access providers in lieu of regulation
   - improving the regulated service access codes regime
   - empowering the Commission to continuously monitor the performance and development of the telecommunications sector and its markets; and
   - providing for the Commission to have regard to statements of government economic policies when exercising its powers.

   The 2006 Bill was passed in December 2006.

6. The Cabinet Policy Committee paper relating to the Telecommunications Stocktake (POL Min (06) 7/9) recognised that the additional functions to be performed by the Commission would result in additional costs, but anticipated that these costs would be recoverable via the Levy. The paper relevantly stated that:

   > **FISCAL IMPLICATIONS**
   >
   > 146 There will be budgetary implications arising from the proposals in order to ensure the Commerce Commission is adequately resourced to ensure effective competition.
   >
   > …
   >
   > 148 The majority of the costs incurred by the Commission should be recoverable from the telecommunications industry via the industry levy and it is likely that any additional funding will be fiscally neutral.

7. Amendments introduced to the Telecommunications Act 2001 by the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011 added further regulatory functions to be carried out by the Commission and the Telecommunications Commissioner relating to the structural separation of Telecom. Following the enactment of the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011, the 2002 Levy Regulations were revoked and replaced by the 2011 Levy Regulations.

Telecommunications Act 2001

8. Section 3(1) of the Telecommunications Act states that the main purpose of the Telecommunications

Act is to regulate the supply of telecommunications services. Section 3(1) of the Telecommunications Act states:

> **3 Purpose**
>
> (1) The main purpose of this Act is to regulate the supply of telecommunications services.

9. Section 9 of the Telecommunications Act specifies that there must be a Telecommunications Commissioner. Section 9 of the Telecommunications Act relevantly states:

> **9 Appointment of Telecommunications Commissioner**
>
> (1) There must be a Telecommunications Commissioner.
>
> (2) The Telecommunications Commissioner is a member of the Commission as provided in section 9(3) of the Commerce Act 1986.
>
> (3) Subject to subsection (4), the Telecommunications Commissioner must be appointed by the Governor-General on the recommendation of the Minister.
>
> …

10. The Telecommunications Commissioner is a member of the Commission appointed under s 9(3) of the Commerce Act 1986.

11. Section 11(3) of the Telecommunications Act states that the Governor General (acting on the recommendation of the Minister) may pass regulations requiring the payment of levies. The levies must be paid to the Minister by telecommunications operators. These levies must be used to defray the Commission's costs for the functions it performs under the Telecommunications Act. Under s 11(1) of the Telecommunications Act, every service provider, or class of service providers, specified in regulations made under s 11(3) must pay to the Minister, in each financial year, a levy of an amount stated in, or calculated or set or reset in accordance with, those regulations for, or in connection with,—
    - the performance of the Commission's functions and duties under the Telecommunications Act; and
    - the exercise of the Commission's powers under the Telecommunications Act.

12. Section 11 of the Telecommunications Act states:

> **11 Levy**
>
> (1) Every service provider, or class of service providers, specified in regulations made under subsection (3) must pay to the Minister, in each financial year or part financial year (as the case may require), a levy of an amount stated in, or calculated or set or reset in accordance with, those regulations for, or in connection with,—
>
> (a) the performance of the Commission's functions and duties under this Act; and
>
> (b) the exercise of the Commission's powers under this Act.
>
> (2) Subsection (1) applies irrespective of the fact that the regulations are made and come into effect after the date on which the financial year or part financial year commences.
>
> (3) The Governor-General may, by Order in Council made on the recommendation of the Minister, make regulations—
>
> (a) specifying the amounts of levies payable under this section:
>
> (b) providing for the method by which those levies will be calculated:
>
> (c) specifying the criteria and other requirements by and against which those levies will be set or reset:
>
> (d) specifying the financial year or part financial year to which those levies apply:
>
> (e) providing for the payment and collection of those levies:
>
> (f) exempting any service provider or class of service providers from paying levies under this section:
>
> (g) providing for waivers or refunds of the whole or any part of any levy paid by any service provider or class of service providers under this section.

13. Section 14 of the Telecommunications Act provides for a late payment penalty for non-payment of the Levy and states:

> **14 Late payment of levy**
>
> (1) If any service provider liable to pay the levy fails to pay the whole amount of that levy by the date specified in regulations made under section 11(3) or section 12(4), the service provider must pay interest on the unpaid amount at the rate of 1.5% per month calculated from the date payment is due.
>
> (2) Interest will be calculated in monthly instalments for each month, or part of each month, that the payment is due.
>
> (3) The amount of any unpaid levy or interest is recoverable in any court of competent jurisdiction as a debt due to the Crown.

Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2011

14. The Explanatory Note to the 2011 Levy Regulations states that they impose levies on telecommunications operators to cover the costs incurred by the Commission in performing and exercising its functions, powers, and duties under the Telecommunications

Act (except certain determinations, where costs are required to be met by parties to the determination, and litigation).

15. Regulation 5 of the 2011 Levy Regulations states that every liable telecommunications operator during all or part of a financial year must pay the Levy for that financial year to the Minister. Regulation 5 of the 2011 Levy Regulations states:

> **5 Levy on telecommunications operators**
>
> Every person who is a telecommunications operator during all or part of a financial year must pay a levy for that financial year to the Minister.

16. Regulation 6 of the 2011 Levy Regulations states that the Levy must be collected annually. The due date is 30 working days after the Commission's final liability allocation determination for the financial year is publicly notified under s 87 of the Telecommunications Act. Regulation 6 of the 2011 Levy Regulations states that:

> **6 How and when levy must be paid**
>
> (1) The Minister must collect the levy annually.
>
> (2) The due date for each payment is the 30th working day after the Commission's final liability allocation determination for the financial year is publicly notified under section 87 of the Act.

17. Regulation 7 of the 2011 Levy Regulations states that the total sum of the Levy to be collected from liable telecommunications operators is calculated by reference to the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Telecommunications Act. These costs are identified as such in the Commission's audited financial statements for the relevant financial year. However, this figure cannot be higher than the amount of Crown revenue appropriated for that financial year within Vote Communications for the non-departmental output class that authorises expenses to be incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Telecommunications Act. Regulation 7 states that:

> **7 Basis of calculation of levy**
>
> (1) The levy payable for the financial year must be calculated by the Minister as follows:
>
> $$\frac{a}{b} \times c$$
>
> where—
>
> a is the amount of the telecommunications operator's final qualified revenue
>
> b is the sum of all telecommunications operators' final qualified revenue
>
> c is the amount of the Commission's costs for the financial year, as specified in subclause (2).
>
> (2) The amount of the Commission's costs for the financial year is the amount—
>
> (a) identified in the Commission's audited financial statements for the financial year as the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Act; but
>
> (b) that does not exceed the total amount appropriated for that financial year within Vote Communications for the non-departmental output class that authorises expenses to be incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Act; and
>
> (c) that does not include—
>
> (i) any costs of the Commission in relation to a determination or application for a determination that are met by the parties to the determination under section 55 of the Act; and
>
> (ii) any costs of the Commission in relation to a determination that are met by a TSO provider under section 94A or 94B of the Act; and
>
> (iii) costs of litigation incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Act.

Overview of some of the Commission's functions, duties and powers under the Telecommunications Act that are (retrospectively) funded by the Levy

18. The Levy covers the amount of all the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Telecommunications Act that are identified as such in the Commission's audited financial statements for the financial year. The only exception to this are those costs specifically excluded by reg 7(2)(c) of the 2011 Levy Regulations (refer para 17 above). The costs the Commission incurs, ultimately paid for by the Levy, relate to a number of different activities. Neither the 2011 Levy Regulations nor the Telecommunications Act explicitly itemise the expenses that the Levy is intended to pay.

19. The following is an overview of some (but not all) of the regulatory functions, duties and powers performed or exercised by the Commission under the

Telecommunications Act that the Levy is intended to (retrospectively) fund:

Market monitoring and information dissemination

- Monitoring competition in, and the performance and development of, telecommunications markets.
- Producing various monitoring reports on a regular basis. These include monitoring reports on telecommunications markets generally and broadband performance specifically. The Commission must make available all reports, summaries or information relating to its monitoring activities.

Reviews and studies

- Section 9A(1)(b) of the Telecommunications Act 2001, as amended in December 2006, empowers the Commission to proactively conduct inquiries, reviews and studies into any matter relating to the telecommunications industry or the long-term benefits of end-users of the telecommunications services within New Zealand.
- This power enables the Commission to take a strategic view of any matter that relates to the telecommunications industry. The Commission must make available all reports, summaries or information relating to its reviews and studies.

The Standard Terms Determination process

- The Standard Terms Determinations (STD) process enables the Commission to make a determination on how a designated or specified service must be supplied with reference to all access seekers and providers of the service. The Commission may, on its own initiative, initiate the STD process for any of the designated or specified services in sch 1 of the Telecommunications Act. Where the Commission's costs for an STD are not met by the parties (under s 55(2) of the Telecommunications Act), they will be recoverable via the Levy. The key events in the STD process are as follows:
  - Commission initiates standard terms development process
  - Commission holds scoping workshop
  - Commission issues notice calling for standard terms proposal from access provider
  - Access provider submits standard terms proposal by specified date
  - Commission advises of receipt of standard terms proposal
  - Interested parties provide submissions on standard terms proposal
  - Commission issues draft standard terms determination
  - Interested parties provide submissions on draft standard terms determination
  - Commission holds conference or consultation with persons other than the parties to the determination (optional)
  - Commission issues standard terms determination.

Reviews and clarifications of Standard Terms Determinations

- The Commission may, on its own initiative, commence a review at any time of all, or any, of the terms specified in a STD.

Structural separation of Telecom

- The Commission has the overall role of monitoring the broader effects of the Telecom separation arrangements. It also uses information from the independent oversight group, Telecom and other sources to identify either breaches or the potential for breaches, of the undertakings by Chorus. Telecom and Chorus are defined terms in the Telecommunications Act.
- The Commission has the explicit role of enforcing compliance with the Telecommunications Act and can make recommendations to the Minister if it considers variations and exemptions to undertakings by Chorus are required.
- The 2011 amendments to the Telecommunications Act introduced a requirement for the Commission to maintain a register of those users to whom Chorus may supply telecommunications services. This is known as the register of non-retail users. The Commission has processes to manage applications to add names to the register, inform people about these applications, and receive complaints about the inclusion of users on the register.

Information disclosure requirements

- The Telecommunications Act contains formal requirements for Telecom and access providers to provide a broad range of information to the Commission for publication. This ensures a wide range of people are informed about the operation and behaviour of prescribed businesses that provide prescribed services. This enables the Commission to monitor and facilitate compliance with prescribed applicable access principles, as those terms are defined in the Telecommunications Act.

Schedule 3 investigations

- The Commission is responsible for matters relating to regulation-making powers for designated services and specified services. This includes conducting formal investigations into whether sch 1 of the Telecommunications Act (Designated services and specified services) should be altered, following the procedure contained in sch 3 of the Telecommunications Act (Procedure for altering regulated services) and reporting the Telecommunications Commissioner's recommendation to the Minister.

Telecommunications Service Obligations

- The Commission administers the Telecommunications Service Obligations (TSO) deeds.

Information disclosure by local fibre companies with undertakings

- Under the 2011 amendments to the Telecommunications Act, local fibre companies building the ultrafast broadband fibre network and Chorus's copper network are required to disclose specified information to the Commission.

Industry Codes

- Draft telecommunications access codes must be submitted to the Commission for approval by the Telecommunications Industry Forum under sch 2 of the Telecommunications Act.

Undertakings

- The Commission must agree to the terms and conditions of any undertaking made by an access provider under sch 3A of the Telecommunications Act that provides a mechanism for an access provider to supply a service to all access seekers on a voluntary basis that avoids the need for and the costs of regulation.

Administering the Telecommunications Development Levy

- The Commission administers the Telecommunications Development Levy.

Telephone number portability

- The Commission is responsible for regulating local and cellular telephone number portability services under the Telecommunications Act.

Charging, Collection and Allocation of the Levy

20. At the beginning of the financial year the Commission's costs for its functions under the Telecommunications Act are set within Vote Communications as non-departmental output expenses. The "Performance Information for Appropriations – Vote Communications" document for the 2012/2013 year (<http://www.treasury.govt.nz/budget/2012/ise/v1/ise12-v1-pia-commun.pdf> accessed 12 February 2013) (Vote Communications document) states that the scope of the appropriation is as follows:

> **Enforcement of Telecommunications Sector Regulation (M88)**
>
> *Scope of Appropriation*
>
> The regulation and monitoring of telecommunication services in accordance with the Telecommunications Act 2001.

21. The Vote Communications document sets out specific "Output Performance Measures and Standards" that the Commission must satisfy when carrying out its function of regulating and monitoring telecommunications services under the Telecommunications Act. These include the:

- Number of determinations (includes determinations, clarifications, reviews and amendments).
- Percentage of stakeholders who find the Commission determinations and supporting reasons clear.
- Number of reports completed (monitoring reports, summary and analysis reports, information disclosure reports, ministerial reports).
- Number of substantial pieces of advice provided to officials to inform policy design.
- Percentage of stakeholders who rate [the Commission's] reports good or above.
- Percentage of reports completed by the set date.
- Number of compliance assessments completed.
- Number of enforcement cases taken.
- Percentage of compliance assessments completed by the set date.

22. For the Ministry, the Levy revenue and the Commission's appropriations are completely separate for GST purposes and they go through separate bank accounts.

23. The appropriation funding is drawn down from Treasury by the Ministry and paid to the Commission GST inclusive as and when required. The Commission brings the appropriation funding to charge as a GST inclusive revenue stream from the Crown. The Commission has the input tax credit on its operating expenses to offset against its GST output tax liability. The Ministry does not return input tax on the appropriation funding paid to the Commission.

24. At the end of the financial year, the Commission's costs for its functions under the Telecommunications Act are outlined in its audited financial statements. The 2011–12 Annual Report for the Commission states, at 57:

> **Cost allocation** – Direct costs are charged directly to outputs within an appropriation. Personnel costs are allocated to outputs based on time records. The indirect costs of support groups, and corporate overhead costs are charged to outputs based on the budgeted relative time records of each output.
>
> **Goods and Services Tax (GST)** – All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. …

25. The Minister then calculates the Levy with reference to reg 7 of the 2011 Levy Regulations and the Commission's actual (GST exclusive) costs, as identified in the Commission's audited financial statements. The Ministry (on behalf of the Crown) invoices and collects the Levy revenue for the Commission. The Levy is paid retrospectively, by all liable telecommunications operators to the Ministry, into the Ministry's Crown bank account. The Ministry then passes the Levy revenue to Treasury. This revenue stream is accounted for by the Ministry (on behalf of the Crown) and not by the Commission.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Levy does not constitute "consideration" (as defined in s 2(1)) for any "supply" (as defined in s 5) of goods and services by the Crown.

b) The Levy paid by liable telecommunications operators under the Telecommunications Act is not subject to GST under s 8.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 6 June 2013 and ending on 6 June 2016.

This Ruling is signed by me on the 6th day of June 2013.

Fiona Heiford
Manager (Taxpayer Rulings)

PUBLIC RULING BR PUB 13/01: INCOME TAX – TREATMENT OF A SUBDIVISION OF SHARES UNDER SECTION CB 4

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 Public Ruling is about how s CB 4 applies to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a company subdivides all of its shares and the following factors apply:

- The directors resolve that all of the shares in the company will be subdivided so that each share splits into an equal number of shares.
- The rights attaching to the shares will continue in existence throughout the subdivision process and will not be altered.
- Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders.
- The subdivision will merely represent the reformatting of each shareholder's interest.

The Arrangement does not include situations where the rights of the shares are varied.

For the avoidance of doubt the Arrangement does not include arrangements where s BG 1 of the Act applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

The subdivision of shares does not result in a disposal of personal property for the purposes of s CB 4.

The period or tax year for which this Ruling applies

This Ruling will apply for a three-year period beginning 21 May 2013 and ending on 20 May 2016.

This Ruling is signed by me on 21 May 2013.

Ainsley Simmonds
Acting Director, Public Rulings

PUBLIC RULING BR PUB 13/02: INCOME TAX – TREATMENT OF A DISPOSAL OF SUBDIVIDED SHARES UNDER SECTION CB 4

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 Public Ruling is about how ss CB 4 and ED 1 apply to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a shareholder holds shares in a company, and those shares were acquired for the purpose of disposal. The company then subdivides its shares, and the following apply:

- The directors resolve that all of the shares in the company will be subdivided so that each share splits into an equal number of shares.
- The rights attaching to the shares will continue in existence throughout the subdivision process and will not be altered.
- Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders.
- The subdivision will merely represent the reformatting of each shareholder's interest.

After the subdivision, the shareholder disposes of some or all of their subdivided shares.

The Arrangement does not include situations where the rights of the shares are varied.

For the avoidance of doubt the Arrangement does not include arrangements where s BG 1 of the Act applies to void the arrangement.

How the Taxation Laws apply to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Section CB 4 applies to the disposal of the subdivided shares.
- The time of acquisition of a subdivided share held on revenue account is the time the original share (which was subdivided) was acquired.
- Under s ED 1, the cost of each subdivided share can be determined by dividing the cost of an original share equally between the subdivided shares into which the original share was divided.

The period or tax year for which this Ruling applies

This Ruling will apply for a three-year period beginning 21 May 2013 and ending on 20 May 2016.

This Ruling is signed by me on 21 May 2013.

Ainsley Simmonds
Acting Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 13/01 AND BR PUB 13/02

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 13/01 and BR Pub 13/02 (the Rulings).

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

Summary

1. In the circumstances set out in the Rulings, a subdivision of shares does not result in a disposal of any shares for the purposes of s CB 4. This is because when a company subdivides shares, the original shares are not cancelled and the shareholder's rights are not altered or terminated by the subdivision.
2. When a shareholder who acquired the original shares on revenue account disposes of a subdivided share, s CB 4 will apply to the disposal. This is because the subdivided shares are the same property as the original shares acquired. Therefore, the time of acquisition of the subdivided shares is the time the original shares were acquired. Under s ED 1, a reasonable method to determine the cost of each subdivided share is to divide the cost of an original share equally between the subdivided shares into which the original share was divided.

Background

3. A subdivision of shares is variously known as a "share split", a "share subdivision", or as a type of "share reorganisation". One reason that a company might undertake a subdivision of shares is to improve the marketability of that company's shares.
4. There are at least three ways to achieve an increase in the amount of shares in a company, for no additional consideration, that are described as a subdivision of shares, namely:
   - existing shares can be cancelled or redeemed, and, for no additional consideration, a greater number of shares can be issued to all shareholders in the same proportion as their original shareholdings;
   - shares in addition to the original shares can be issued, for no additional consideration, to all shareholders in the same proportion as the shares already held;
   - existing shares can be converted into a greater number of shares for no consideration.

5. The Rulings are concerned with only the third type of subdivision of shares.

6. Section CB 4 provides that an amount derived on the disposal of personal property acquired for the purpose of disposal, is income of the person. A share is a type of personal property: s 35 of the Companies Act 1993 (CA 1993). Therefore, in this context, questions arise as to the application of s CB 4 to a subdivision of shares and to the disposal of a subdivided share.

Application of the legislation

7. The Rulings consider two situations. These situations represent two points in time at which s CB 4 could apply to subdivided shares, namely the time at which the:
   - shares are subdivided;
   - subdivided shares are disposed of.
8. Whether s CB 4 applies in these situations depends on whether the subdivided shares can be regarded as the same property as the original shares.

Can the subdivided shares be regarded as the same property as the original shares?

9. Two broad requirements of s CB 4 must be satisfied. If these requirements are met, an amount that the person derives from disposing of the personal property is income of the person. The first requirement is that a person acquires personal property for the purpose of disposing of it. The second requirement is that the person disposes of the personal property.

BINDING RULINGS

10. The grammatical construction of s CB 4 shows that the property disposed of must be the same property as that acquired. When a subdivided share is then disposed of, the question arises as to whether the subdivided shares are the same property as the original shares. The answer to this question will also assist in determining the time of acquisition of the subdivided shares for the purposes of s CB 4.
11. In determining whether the subdivided shares can be regarded as the same property as the original shares, it is helpful to consider:
    - What is the nature of a share?
    - Does a subdivision of shares involve an issue of shares?
    - Have the original shares been disposed of or cancelled?
    - Have the shareholders' rights changed as a result of the subdivision of shares?
    - Does the Act provide any guidance?

What is the nature of a share?

12. It is generally accepted that a share is a bundle of rights and obligations conferred under a contract between the shareholders and the company: *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279 (Ch); *Bradbury v English Sewing Cotton Ltd* [1923] AC 744 (HL); *IR Commrs v Laird Group plc* [2003] UKHL 54. This was confirmed by the New Zealand Court of Appeal in *Robertson v Bicknell* (CA129/01, 25 March 2002). In *Robertson*, the court also confirmed that the nature of the property in a share is the interest of a person in the company, that interest being comprised of various rights and obligations (at [23]).
13. The CA 1993 and the general law on shares suggest that shares are an "aliquot" (meaning a portion of a larger whole) interest in a company; that is, a bundle of rights and obligations representing the shareholder's proportionate interest in the company. The removal of par and nominal values for shares under the CA 1993 reinforces this approach.
14. Section 35 of the CA 1993 provides that a share in a company is personal property. In addition, s 36 of the CA 1993 sets out the basic rights and powers that attach to shares. These basic rights and powers include the right for the shareholder to vote at a meeting of the company on any resolution, the right to an equal share in dividends authorised by the board, and the right to an equal share in the distribution of surplus assets of the company. It is important to note that the rights and powers conferred by this section may be negated, altered or added to by the constitution of the company. Therefore, in any given situation, the constitution of a company (if it has one) will be an important factor in determining the nature of a share and the rights and powers attached to it.

Does a subdivision of shares involve an issue of shares?

15. If a subdivision of shares involves an issue of new shares, this may indicate that subdivided shares are different property from the original shares. Sections 41 to 51 of the CA 1993 provide rules on issuing shares. However, the CA 1993 does not provide any guidance about how to achieve a subdivision of shares. There is only one reference in the CA 1993 to subdivisions of shares and that is in s 48. Section 48 is an exception to the requirements in s 47 of the CA 1993 that apply to the issuing of shares by a company after its registration. One view is that this shows that a subdivision must involve an issue of shares—otherwise there would be no need for the express exclusion. The other view is that this was simply to avoid any doubt in this regard. Apart from this, the CA 1993 is silent about how subdivisions should be effected. It is difficult therefore to draw an inference from the CA 1993 as to whether a subdivision of shares involves an issue of new shares. In practice, a company's annual return is the method by which the Companies Register is updated to reflect changes in the number of shares held and by whom.
16. By comparison, the Companies Act 1955 (CA 1955) did include a procedure for the subdivision of shares. Sections 70 and 71 of the CA 1955 allowed a company to alter the conditions of its memorandum to, among other things, "subdivide its shares … into shares of smaller amount" and required the company to notify the Registrar. This process was a separate one from that required to issue shares: see, for example, ss 14 60, 70(1)(a), 72 and reg 2, Table A, Sch 3. This suggested that subdivisions of shares did not involve an issue of shares.
17. It has been suggested that the issue of shares involves the creation of property: *FCT v St Helens Farm (ACT) Pty Ltd* (1981) 146 CLR 336. Cases on the issue of shares support the view that a subdivision of shares does not involve an issue of shares. The thrust of these cases is that an issue of shares involves something leaving the company and being provided to the shareholder: *Central Piggery Co Ltd v McNicoll* (1949) 78 CLR 594; *National Westminster Bank plc v IR Commrs* (1994) 12 ACLC 3,215 (HL). The Commissioner considers that, in the case of a subdivision of shares, nothing has left the company or been provided to the shareholder. The shareholder has the same bundle of rights before and after the subdivision.

18. The CA 1955 suggested that subdivisions of shares did not involve an issue of shares. As noted, there is no clear process for subdivisions of shares under the CA 1993, but there is also no indication that the CA 1993 was intended to change the position under the CA 1955 in relation to subdivisions of shares. Given that the case law on what it means to issue shares shows that an issue involves something being provided by the company to the shareholder, it would seem that a subdivision of shares does not involve an issue of shares. Therefore, the Commissioner considers that the better view is that subdivisions of shares should be viewed as not involving an issue of shares.

Have the original shares been disposed of or cancelled?

19. The term "dispose" is not defined in s YA 1 for the purposes of s CB 4. (The term is defined for the purposes of other sections in the Act, but these definitions do not assist in this inquiry.) The courts have held that "disposal" means that the property is "got rid of", and is no longer in the control or possession of the disposer in any capacity: *FCT v Wade* (1951) 84 CLR 105; *Lyttelton Port Co Ltd v CIR* (1996) 17 NZTC 12,556 (HC); *Coles Myer Ltd v Commissioner of State Revenue (VIC)* (1998) ATC 4,537 (VICCA). As a result, the Commissioner considers that a "disposition" and/or "disposing" of property must involve the transfer or alienation of that property by the disposer.

20. Further, the provisions in the CA 1993 dealing with the cancellation of shares do not expressly apply to share subdivisions. This suggests that a subdivision does not involve the cancellation of the shares being subdivided. In addition, the case law shows that a "disposition" and/or "disposing" of property must involve total alienation of that property by the disposer. The absence of the cancellation of the existing shares and the fact the shareholder's interests in the company are never alienated on a subdivision of shares suggests the original shares continue in existence.

21. In addition, when a company subdivides all the shares in the company, the shareholders do not lose control of their proportionate shares in the company between holding the original shares and holding the subdivided shares.

Have the shareholders' rights changed as a result of a subdivision of shares?

22. As noted above, the basic rights attaching to a share (under the CA 1993) include the right to vote, the right to an equal share in dividends and the right to an equal share in the distribution of surplus assets. It might be argued that a subdivision of shares involves changes to a shareholder's rights in some way; given, for example, the number of votes held by the shareholder may increase in nominal terms. However, if this is viewed in terms of a share being a bundle of rights, then nothing has changed. The proportionate interest (and rights) that the shareholder had before and after the subdivision of shares remains the same. Said another way, the shareholder has, for example, a greater number of votes but the same proportionate voting interest in the company. Therefore, the Commissioner considers that a subdivision of shares has little effect on shareholders' rights—the subdivision results in more shares, but the shareholders' proportionate interest in the company does not change.

23. The cases on subdivisions of shares in other legal contexts generally take the view that a subdivision of shares does not give rise to new property: *Whittome v Whittome* (No 1) (1994) SLT 114 (OH); *Greenhalgh v Arderne Cinemas Ltd* [1946] All ER 512 (CA). There is also a suggestion that the subdivided shares could be traced back to and identified with the original shares: *In re Financial Corp* (1866–67) LR 2 Ch App 714 (Ch). In addition, in cases concerned with whether a bequest of shares has "adeemed", the question is whether the property exists as substantially the same thing at the death of the testator. (A gift will "adeem"—that is, be extinguished—in circumstances where, for example, there is a change in the nature of the gift between the testator making the will and the testator's death.) In relation to a subdivision of shares, in several cases it has been accepted that the subdivided shares are something that has been changed in name and form only, but that is substantially the same thing as the original shares: *Re Greenberry, Hops v Daniell* (1911) 55 Sol J 633; *In re Faris, Goddard v Overend* [1911] 1 IR 165 (Ch); *In re Clifford, Mallam v McFie* [1912] 1 Ch 29 (Ch); *Guardian Trust and Executors Co of NZ Ltd v Smith* [1923] NZLR 1,284 (SC).

24. Some support for the view that subdivided shares are the same property as the original shares may also be taken from cases on "identity of property". These cases show that where the legal rights acquired are different in nature from those sold, then they could not be considered to be the same property: *McClelland v FCT* (1970) 120 CLR 487; *AL Hamblin Equipment Pty Ltd v FCT* (1974) 74 ATC 4,310 (HCA). However, cases on "identity of property" also suggest that a mere subdivision of land does not change the nature of the legal rights in the property: *Moruben Gardens Pty Ltd v FCT* 72 ATC 4,147. In that case Mason J regarded the sale of all of the subdivided units as constituting a disposition of the entire estate in fee simple.

He concluded that there was identity of property before and after the subdivision because the nature of the legal rights in the property remained the same.

Does the Act provide any guidance?

25. Little guidance can be gained directly from the Act. Only one section of the Act deals with subdivisions of shares directly; that is, s EX 68 (this section uses the term "share split"). The wording of this section might suggest that a new interest arises. However, on balance the Commissioner does not think this is the case. The wording of this section reflects the need to ensure the formulae in the foreign investment fund rules work when the number of shares in a foreign investment fund has increased without any new value being introduced to the foreign investment fund.

26. The proposed amendments to the definition of "bonus issue" in the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill, when enacted, will also refer to "subdivisions of shares". This amendment will clarify that subdivisions of shares are excluded from the dividend rules. The Rulings consider whether s CB 4 applies to subdivisions of shares and the disposal of subdivided shares. This proposed amendment does not affect the reasoning and conclusions in the Rulings.

Conclusion

27. In summary, under the CA 1993, it appears that a subdivision of shares in the circumstances set out in BR Pub 13/01 and BR Pub 13/02 does not involve an issue of new shares or the cancellation of the original shares—the original shares are merely reformatted or reorganised. Overall, the Commissioner considers that, when shares are subdivided, in such cases the shareholder's rights in the company have not changed, even though the form in which those rights are held has changed. As a result, the Commissioner considers that the subdivided shares are the same property as the original shares for the purposes of s CB 4.

Does s CB 4 apply at the time the shares are subdivided?

28. When a company subdivides shares, the Commissioner considers that at no point does the shareholder give up or lose their share rights as a result of the subdivision. The Commissioner considers that support for this view can be taken from the decision in *Whittome v Whittome* (No 1) (1994) SLT 114 (OH). In *Whittome*, the court considered that a subdivision did not affect the identity of the property held by the shareholders, nor did it affect the proportion of the ownership held by the shareholders. The court considered that the shares were not affected by the subdivision and the shares held following the subdivision were the same property as the shares before the subdivision.

29. Given this, the Commissioner considers that s CB 4 does not apply at the time a person's shares are subdivided.

Does s CB 4 apply at the time subdivided shares are disposed of?

30. An amount derived by a person on the disposal of subdivided shares, where the original shares were acquired for the purpose of disposal, will be income of the person under s CB 4. Conversely, s CB 4 will not apply to an amount derived by a person on the disposal of subdivided shares where the original shares were not acquired for the purpose of disposal. This is because the shares held by the person after a subdivision can be regarded as the same property as the shares held by the person before the subdivision.

What is the time of acquisition and cost base of subdivided shares held on revenue account?

31. Given that subdivided shares can be regarded as the same property as the original shares, the Commissioner considers that the time of acquisition of the subdivided shares is the time the original shares were acquired.

32. The cost of the original shares may be used to determine the cost base of the subdivided shares on revenue account for purposes of s ED 1.

33. The Commissioner considers that a reasonable method to determine the cost of a subdivided share is to divide the cost of an original share equally between the subdivided shares into which the original share was divided.

Examples

34. The following examples are included to help explain the application of the law.

Example 1 – shares acquired for the purpose of disposal

35. On 21 July 2010, Matiu purchased 500 shares in Barry's Bananas Ltd (BBL) for $10 per share. On 10 January 2011, Matiu purchased another 500 shares in BBL for $15 per share. BBL has one class of shares with 100,000 shares on issue. Matiu acquired his 1,000 shares for the purpose of disposing of them at a profit in the future. Therefore, Matiu holds these shares on revenue account.

36. The directors of BBL decide to subdivide all the shares in BBL so that there will be 400,000 shares on issue. The directors pass a resolution stating:

The Board resolves to subdivide (for nil consideration) each Share in the Company into four Shares of the same type. The subdivision of the Company's Shares will take effect on 1 May 2011.

37. The rights attaching to BBL's shares will continue in existence throughout the subdivision process and will not be altered. Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders. In addition, the subdivision will merely represent the reformatting of each shareholder's interest.

38. When the subdivision takes place, BBL's share register is updated with the new numbers of shares. BBL also informs the Companies Office of the subdivision and the new number of shares is recorded on the Companies Register.

39. After the shares are subdivided, Matiu has 4,000 shares. However, Matiu still has the same proportionate interest in the company and the same rights under the shares as he did before the subdivision. In addition, at no point during the subdivision did Matiu not hold shares in BBL. Therefore, s CB 4 will not apply at this time because Matiu has not disposed of anything.

40. On 18 May 2011, Matiu sells his 4,000 shares to Wiremu for $5 per share. Matiu receives $20,000 from Wiremu in return for the shares. At this point, the requirements of s CB 4 have been met; that is, Matiu has derived an amount from the disposal of property that he acquired for the purpose of disposal. As a result, Matiu will have derived an amount of income on the sale of the shares. Matiu does not acquire or dispose of any more shares in BBL in 2011.

41. The cost base of the subdivided shares is the cost of each of the original shares divided equally among the number of subdivided shares into which the original share was split. That is, the cost of each original share is divided equally across four subdivided shares.

42. Matiu acquired 500 shares before the subdivision for $10 per share. After the subdivision those 500 shares became 2,000 shares. As a result, the cost per share of each subdivided share is $2.50.

43. Matiu also acquired a further 500 shares before the subdivision for $15 per share. After the subdivision those 500 shares became 2,000 shares. The cost per share of each subdivided share is $3.75.

44. In the 2011-12 income year, the amount that Matiu derives on the disposal of the shares will be income. In addition, the opening value of the shares (ie, the cost of the shares) will be allowed as a deduction under the matching rules in s ED 1. Using the cost bases identified above, this is calculated in the following way:

- The acquisition cost of the subdivided shares is $5,000 for the first 500 shares acquired, and $7,500 for the second 500 shares acquired. This gives a total acquisition cost for the 4,000 shares of $12,500.
- Matiu sold all 4,000 shares to Wiremu for $20,000.
- The profit of $7,500 that Matiu derived from the sale of the shares will form part of Matiu's net income.

Example 2 – shares not acquired for purpose of disposal

45. On 18 February 2011, Wei purchased 50 shares in BBL. Wei bought the shares as a long-term investment for his family. On 20 March 2011, BBL announces that it will subdivide its shares. After the subdivision, Wei will have 200 shares. Soon after, Wei is diagnosed with a serious illness. He decides to sell some of his shares to help pay for his treatment.

46. BBL subdivides its shares on 1 May 2011. On 2 May 2011, Wei sells 125 of his shares to Gareth. In this situation, s CB 4 will not apply to the amount that Wei derives on the disposal of the 125 shares. This is because, at the time Wei acquired the shares, he did not acquire the shares for the purpose of disposal.

References

Subject references
Cancellation of shares; Disposal; Issue of shares; Personal property; Subdivision of shares
Legislative references
Companies Act 1993, ss 35, 48
Income Tax Act 2007, ss CB 4, ED 1, EX 68
Case references
AL Hamblin Equipment Pty Ltd v FCT (1974) 74 ATC 4,310 (HCA)
Bedford Investments Ltd v CIR [1955] NZLR 987 (SC)
Borland's Trustee v Steel Brothers & Co Ltd [1901] 1 Ch 279 (Ch)
Bradbury v English Sewing Cotton Ltd [1923] AC 744 (HL)
Case L43 (1989) 11 NZTC 1,262 (TRA)
Central Piggery Co Ltd v McNicoll (1949) 78 CLR 594

Clifford, In re, Mallam v McFie [1912] 1 Ch 29 (Ch)
Coles Myer Ltd v Commissioner of State Revenue (VIC) (1998) ATC 4,537 (VICCA)
Faris, In re, Goddard v Overend [1911] 1 IR 165 (Ch)
FCT v St Helens Farm (ACT) Pty Ltd (1981) 146 CLR 336
FCT v Wade (1951) 84 CLR 105
Financial Corp, In re (1866–67) LR 2 Ch App 714 (Ch)
Greenberry, Re, Hops v Daniell (1911) 55 Sol J 633
Greenhalgh v Arderne Cinemas Ltd [1946] All ER 512 (CA)
Guardian Trust and Executors Co of NZ Ltd v Smith [1923] NZLR 1,284 (SC)
IR Commrs v Laird Group plc [2003] UKHL 54
Lyttelton Port Co Ltd v CIR (1996) 17 NZTC 12,556 (HC)
McClelland v FCT (1970) 120 CLR 487 (PC)
National Westminster Bank plc v IR Commrs (1994) 12 ACLC 3,215 (HL)
Public Trustee v CIR [1961] NZLR 1,034 (SC)
Robertson v Bicknell (CA129/01, 25 March 2002)
Whittome v Whittome (No 1) (1994) SLT 114 (OH)

APPENDIX – LEGISLATION

Income Tax Act 2007

1. Section CB 4 provides:

CB 4 Personal property acquired for purpose of disposal

An amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it.

Section ED 1 relevantly provides:

ED 1 Valuation of excepted financial arrangements

Valuation methods for excepted financial arrangements

(1) A person who has revenue account property that is an excepted financial arrangement must determine the value of the arrangement at the end of each income year at cost.

…

Cost-flow methods

(5) The person must use 1 of the following cost-flow methods to allocate costs:

(a) the first-in first-out cost method; or

(b) the weighted average cost method.

…

Persons complying with generally accepted accounting practice

(6) A person who complies with generally accepted accounting practice must comply with the consistency and disclosure requirements of NZIAS 8 or an equivalent standard issued in its place.

Other persons

(7) A person who does not comply with generally accepted accounting practice—

(a) must be consistent from 1 income year to the next in their choice of 1 of the cost-flow methods described in subsection (5); and

(b) may change their cost-flow method if—

(i) the change is justified by sound commercial reasons and for this purpose, the advancement, deferral, or reduction of an income tax liability is not a sound commercial reason; or

(ii) the change is required by another provision in this subpart; and

(c) must keep sufficient details of any such change, and the reasons for it, under section 22 of the Tax Administration Act 1994.

…

Worthless arrangements

(8) If an excepted financial arrangement has no present or likely future market value and has been written off as worthless, its closing value is zero.

…

Use of value

(9) The value determined under this section is—

(a) the closing value of the excepted financial arrangement for the purposes of section CH 1 (Adjustment for closing values of trading stock, livestock, and excepted financial arrangements); and

(b) the opening value of the excepted financial arrangement for the next income year for the purposes of section DB 49 (Adjustment for opening values of trading stock, livestock, and excepted financial arrangements).

PUBLIC RULING BR PUB 13/03: INCOME TAX – TREATMENT OF UNCLAIMED AMOUNTS OF $100 OR LESS

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 s CB 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by a holder of an amount of $100 or less:

- to which the proviso to s 4(1) of the Unclaimed Money Act 1971 (UMA 1971) applies; and
- that is received by the holder in the ordinary course of carrying on its business (and, therefore, is not capital in nature).

The Arrangement does not include amounts while they are held on trust and cannot be applied by the holder for their own benefit (or for the benefit of any other person or for any purpose or object).

For the purposes of this Ruling, the term "holder" has the meaning attributed to it by s 5 of the UMA 1971.

For the purposes of this Ruling, the term "business" has the meaning attributed to it by s YA 1.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The amount will be income derived under s CB 1 when it:
  - has been applied by the holder for its own benefit (or for the benefit of any other person or for any purpose or object); and
  - is probable that the amount will not have to be repaid.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning on the first day of the 2013–14 income year to the last day of the 2016–17 income year.

This Ruling is signed by me on 6 June 2013.

Ainsley Simmonds
Acting Director, Public Rulings

PUBLIC RULING BR PUB 13/04: INCOME TAX – TREATMENT OF UNCLAIMED AMOUNTS OF $100 OR LESS

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 s CB 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by a holder of an amount of $100 or less to which the Unclaimed Money Act 1971 (UMA 1971) applies that is:

- received by the holder in the ordinary course of carrying on its business (and, therefore, is not capital in nature); and
- held on trust and cannot be applied by the holder for their own benefit (or for the benefit of any other person or for any purpose or object).

For the purposes of this Ruling, the term "holder" has the meaning attributed to it by s 5 of the UMA 1971.

For the purposes of this Ruling, the term "business" has the meaning attributed to it by s YA 1.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The amount will not be income derived under s CB 1 while it is held on trust.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning on the first day of the 2013–14 income year to the last day of the 2016–17 income year.

This Ruling is signed by me on 6 June 2013.

Ainsley Simmonds
Acting Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 13/03 AND BR PUB 13/04

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 13/03 and BR Pub 13/04 (the Rulings).

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

Summary

1. Many businesses hold money that is owing to another person. In New Zealand, the Unclaimed Money Act 1971 (UMA 1971) sets out rules that apply to holders of this unclaimed money. Generally, after a certain period, unclaimed money becomes payable to the Commissioner of Inland Revenue. However, the amount ceases to be unclaimed money (although the owner of the money may still be entitled to repayment) where the amount of unclaimed money:
   - does not exceed $100 per owner (the person entitled to the money); and
   - the amount is applied by the holder for their own benefit (or for the benefit of any other person or for any purpose or object) within prescribed timeframes.

   If the holder does not apply the amount for its own benefit, that amount will continue to be unclaimed money and will be payable to the Commissioner of Inland Revenue.
2. At issue is the tax treatment of these amounts. In particular, whether they can be business income of a taxpayer.
3. For amounts of unclaimed money of $100 or less, it is concluded that while money is held on trust and cannot be (and has not been) applied by the holder for their own benefit (or for the benefit of any other person or for any purpose or object) it cannot be income of the holder. These amounts remain subject to the UMA 1971 and must be paid to the Commissioner within the specified timeframes.
4. An unclaimed amount (of $100 or less) not held on trust will be derived when it:
   - has been applied by the holder for its own benefit (or for the benefit of any other person or for any purpose or object); and
   - is probable that the amount will not have to be repaid (this would include situations that mean the amount is not legally recoverable—for example, a contractual term or limitation period).
5. Whether it is probable that an amount will not be repaid will depend on the particular business. Business records and accounting treatment are likely to be relevant to determining this.
6. If a holder has recognised a previously unclaimed amount as income and subsequently returns that amount to the owner, the holder will be entitled to a deduction under s DA 1(b).

Background

7. In the *Technical Rulings Manual*, paragraph 73.8.2 provided that unclaimed money applied by holders for their own benefit cannot be classified as either receipts or profits arising in the normal course of the holder's trading activities.
8. The *Technical Rulings Manual* has not been updated since September 1998 and cannot be relied on as representing the Commissioner's current view (see 'Inland Revenue Technical Rulings – now limited to historic value' *Tax Information Bulletin* Vol 10, No 9 (September 1998)). It appears that since 1998 there has been some doubt about the correct tax treatment of these unclaimed amounts. These Rulings set out the Commissioner's current view.

Application of the Legislation

9. The following analysis starts with a summary of the provisions of the UMA 1971. It then considers relevant case law on the timing of derivation of income and a line of United Kingdom (UK) cases that look at when unclaimed money will be trading profits of the holder.

Summary of Unclaimed Money Act 1971

10. Section 4(1)(a)–(d) of the UMA 1971 defines amounts that are "unclaimed money". This section includes specific types of amounts that are unclaimed money and the period (6 years or 25 years) after which the amounts become unclaimed money.
11. Section 4(1)(e) of the UMA 1971 sets out a general catch-all provision. Broadly, any money that has been owing by any holder for 6 years immediately following the date on which the money has become payable by the holder will be "unclaimed money".
12. The proviso to s 4(1) of the UMA 1971 states:

    Provided that money of any of the kinds referred to in this subsection shall cease to be unclaimed money where—

    (i) In respect of any one owner it does not exceed $100 in total; and

    (ii) Before the 1st day of June next succeeding the end of the period of 6 years or, as the case may be, 25 years specified in this subsection, that unclaimed money is, without limiting any claim

> any owner may have thereto, applied by the holder for his own benefit or for the benefit of any other person or for any purpose or object.

13. Consequently, an amount will cease to be unclaimed money where it does not exceed $100 and it is applied for the benefit of the holder (or for the benefit of any other person or for any purpose or object) within the prescribed timeframes. However, this does not affect any claim that the owner of the money may have against the holder for repayment.
14. Section 4(2) of the UMA 1971 also excludes certain amounts from being unclaimed money. These include certain dividends, rebates payable by a mutual society, and benefits payable from any pension or superannuation fund.
15. "Holder" is widely defined in s 5 of the UMA 1971. The term includes any company incorporated in New Zealand and any company or bank carrying on business in New Zealand. It also includes certain holders (who are not companies) who are obliged to account for only particular kinds of unclaimed money (for example, auctioneers in respect of the balance of any proceeds of goods sold at auction and real estate agents in respect of money held in the real estate agent's trust account).
16. Other persons may elect to be holders and comply with the provisions of the UMA 1971.
17. The UMA 1971 imposes certain obligations on holders of unclaimed money. These obligations include:
    - keeping a register of unclaimed money in accordance with s 6 of the UMA 1971;
    - notifying owners and the Commissioner of entries in the unclaimed money register in accordance with s 7 of the UMA 1971;
    - paying the unclaimed money to the Commissioner in accordance with the period specified in s 8 of the UMA 1971 (at this time the holder is relieved of all further liability to any claimant in respect of the money).

Failure to comply with these obligations is an offence (s 13 UMA 1971).

18. At issue is the tax treatment of amounts that come within the proviso to s 4(1) of the UMA 1971. In particular, whether these amounts can be business income of a taxpayer. These are amounts that would, in the absence of the proviso, be unclaimed money (and the holder subject to the obligations outlined above). Instead, where an amount does not exceed $100 and it is applied for the benefit of the holder (or for the benefit of any other person or for any purpose or object) within the prescribed timeframes, it will cease to be unclaimed money. Therefore, the UMA 1971 will no longer apply to it.

When an amount will be business income

19. 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.

20. An amount will be income where it is "derived" from a business. The following discussion applies where:
    - a taxpayer is carrying on a business;
    - the amounts in question are received in the ordinary course of that business;
    - the amounts are not capital in nature; and
    - no specific timing regime applies to deem derivation to be at a particular time.
21. Case law has established two main methods of recognising income for tax purposes: the cash or receipts method, and the accruals or earnings method. The accruals method is generally the most appropriate one for calculating business income. This usually requires the realisation of income on the basis of ordinary commercial principles (unless a more specific provision of the Act applies).
22. It is possible that derivation could occur on receipt or at some point following receipt, or that derivation never occurs. Determining the correct point in time requires consideration of the case law on the meaning of derivation.
23. The leading case in this area is *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 114 CLR 314. In *Arthur Murray* the taxpayer carried on a business of giving dancing lessons. Courses of tuition were available for 5, 15 or 30 hours of private tuition to be taken within a year. Some students contracted for 1,200 hours of tuition to be taken at any time during the student's lifetime. Payment for a course of lessons was often made in advance. The students were given no contractual right to a refund (the terms of the contract prohibited it). However, refunds were sometimes given. The taxpayer argued that fees received in advance of tuition were not taxable income at the time of receipt. The court agreed, finding (at 318) as follows:

> [Income] refers to amounts which have not only been received but have "come home" to the taxpayer; and

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that must surely involve, if the word "income" is to convey the notion it expresses in the practical affairs of business life, **not only that the amounts received are unaffected by legal restrictions, as by reason of a trust or charge in favour of the payer–not only that they have been received beneficially–**but that the situation has been reached in which they may properly be counted as gains completely made, so that there is neither legal nor business unsoundness in regarding them without qualification as income derived.

The ultimate inquiry in either kind of case, of course, must be whether that which has taken place, be it the earning or the receipt, is enough by itself to satisfy the general understanding among practical business people of what constitutes a derivation of income. A conclusion as to what that understanding is may be assisted by considering standard accountancy methods, for they have been evolved in the business community for the very purpose of reflecting received opinions as to the sound view to take of particular kinds of items.

...

Likewise, as it seems to us, in determining whether actual earning has to be added to receipt in order to find income, **the answer must be given in the light of the necessity for earning which is inherent in the circumstances of the receipt. It is true that in a case like the present the circumstances of the receipt do not prevent the amount received from becoming immediately the beneficial property of the company; for the fact that it has been paid in advance is not enough to affect it with any trust or charge, or to place any legal impediment in the way of the recipient's dealing with it as he will**. But those circumstances nevertheless make it surely necessary, as a matter of business good sense, that the recipient should treat each amount of fees received but not yet earned as subject to the contingency that the whole or some part of it may have in effect to be paid back, even if only as damages, should the agreed quid pro quo not be rendered in due course. **The possibility of having to make such a payment back** (we speak, of course, in practical terms) **is an inherent characteristic of the receipt itself**. In our opinion it would be out of accord with the realities of the situation to hold, while the possibility remains, that the amount received has the quality of income derived by the company. **For that reason it is not surprising to find, as the parties in the present case agree is the fact**, that according to established accountancy and commercial principles in the community the books of a business either selling goods or providing services are so kept with respect to amounts received in advance of the goods being sold or of the services being provided that the amounts are not entered to the credit of any revenue account until the sale takes place or the services are rendered: in the meantime they are credited to what is in effect a suspense account, and their transfer to an income account takes place only when the discharge of the obligations for which they are the prepayment justifies their being treated as having finally acquired the character of income.

[Emphasis added]

24. Several New Zealand cases have followed *Arthur Murray*. *Arthur Murray* was cited with approval in *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) in relation to the principle that an amount needs to be received beneficially by the taxpayer before it will be derived.

25. In *CIR v Molloy* (1990) 12 NZTC 7,146 (HC) the taxpayer was a life insurance agent. He received commissions in advance subject to terms requiring repayment if the policy was terminated within a certain timeframe. The court found that the commissions were not income at the time of receipt. Thomas J stated at 7,152:

In my view the advances made to the agent by the company in this case on account of commission do not have the quality of income derived by the agent at the time of receipt. **The possibility or inherent risk that such advances may have to be repaid (only about 5% in the case of the respondent but up to 30% on average for the company's agents as a whole) is significant, and it is an integral part of the advance, or the receipt of the advance, itself**. For the very good reason that the company wishes to provide an incentive for the agent to solicit soundly based business and then, if necessary, work to ensure that the policies entered into are sustained for a sufficient period to ensure that they are viable, the arrangement contemplates that he will not have earned his commission unless the policy remains in force for two years.

In my opinion, it is these factors which deprive the advances made from having the quality of income earned and derived by the agent at the time they are received.

[Emphasis added]

26. *Bowcock v CIR* (1981) 5 NZTC 61,062 (HC) concerned an employee who took study leave. Under the terms of the arrangement, the taxpayer received his normal salary. If he left his employment within a certain time after finishing his course, some of the money had to be repaid. The taxpayer did leave his employment and had to repay certain amounts. He claimed that these amounts were never part of his income. The court distinguished *Arthur Murray*, finding that the amounts became the absolute property of the taxpayer when they were paid. Whether any liability arose in the future to repay any part of the money depended entirely on the course the objector chose to take.

27. The principles from *Arthur Murray* were also applied in *Case N30* (1991) 13 NZTC 3,266 (TRA). The taxpayer in *Case N30* carried on a courier business. As part of its business, the taxpayer sold pre-paid books of tickets of varying denominations. The tickets had no expiry date. There was no contractual right to a refund, although the taxpayer would usually give a refund for unused tickets if asked. Some of the tickets were never redeemed. Amounts received were not returned as income when they were received, but were returned as income when they were redeemed. It was agreed that this was generally the appropriate tax treatment. At issue was the treatment of amounts that were never redeemed and whether these should be returned as income. It was accepted that the amount could not be accurately calculated. Judge Bathgate held that when the taxpayer could say as a matter of probability that a ticket would not be redeemed, the amount should be included as income.

28. The taxpayer in *A Elson (Inspector of Taxes) v Prices Tailors Ltd* [1963] 1 All ER 231 (ChD) carried on business as a tailor making made-to-measure garments. When a customer placed an order, they were required to pay a deposit. If, subsequently, the customer declined to take the garment, the taxpayer would refund the deposit (although contractually it did not have to do so). However, often neither the garment nor the deposit was claimed. At issue was whether the unclaimed deposits were trading receipts in the year in which they were paid.

29. The court found that the payments were true deposits, rather than part-payments (as the taxpayer had argued). Consequently, the amounts belonged to the taxpayer at the time they were paid (as there was no legal requirement to refund them). The court went on to find that the deposit amounts were trading receipts in the year in which they were received. That the taxpayer would always refund the amounts if asked did not change this.

30. It might be suggested that *Prices Tailors* is inconsistent with the decision in *Arthur Murray*. *Prices Tailors* concerned a deposit towards a supply of goods and the court held that the deposit was derived when it was received. On the other hand, *Arthur Murray* concerned a full payment for the provision of services in the future and the court held that the amount was not derived until the services had been performed. The cases are consistent in that they both look at the legal obligations (the amounts paid were non-refundable) rather than what happened in practice. However, *Prices Tailors* did not appear to consider the fact that, at the time the deposit was paid, the taxpayer had not fulfilled the requirements of the contract (ie, making the suit available to the taxpayer).

Summary of principles from the cases

31. The following principles can be taken from the above cases:
    - The word "income" conveys the notion it expresses in the practical affairs of business life. It is necessary to ask whether what has taken place is enough by itself to satisfy the general understanding among practical business people of what is derivation of income.
    - An amount will be income when the earning process is complete. In the case of prepaid services, this will usually be when the services have been performed.
    - Where it is probable that the services will not have to be performed and the amount will not have to be repaid, then the amount should be income.
    - It is necessary to consider the circumstances of receipt. For example, whether the amount is subject to a contingency of repayment is a relevant factor. Similarly, for an amount to be derived it must have been beneficially received by the taxpayer (ie, not be subject to legal restrictions such as a trust or charge that prevent the taxpayer dealing with the amount in their own interests).

United Kingdom cases

32. Several UK cases consider whether (and when) amounts received by taxpayers that may be subject to repayment are trading receipts that should be taken into account in calculating the taxpayer's profits.

33. *Lincolnshire Sugar Co Ltd (in liquidation) v Smart* (HMIT) [1937] 1 All ER 413 (HL) considered "advances" payable to sugar manufacturers. The advances became repayable in the event of imported sugar rising to a certain price, or in certain other events such as a winding up of the company. The appellant company received weekly advances amounting to £17,494 5s 7d. This sum was included as a liability in its balance sheet. No part of the sum ever became repayable. The issue was whether the £17,494 5s 7d was a trading receipt of the company in the year it was received. The company contended that the advances were not trading receipts or, if the advances were trading receipts, they could not be brought into account as such, so long as they remained subject to repayment.

34. Lord MacMillan concluded that the amounts were trading receipts. The fact the payments were called advances and were repayable if certain contingencies occurred was not decisive. Rather he was influenced

by the fact the payments were made to the company so that the money could be used in its business.

35. *Morley (Inspector of Taxes) v Tattersall* [1938] 3 All ER 296 (CA) involved a firm of auctioneers. Its conditions of sale provided that vendors should receive the purchase money following the sale, and that no money would be paid without a written order. As a result of the operation of these conditions, large sums of money from time to time remained unclaimed in the hands of the firm. When a new partner was admitted in 1922, £13,022 6s 4d in respect of unclaimed balances for years before 1908 was transferred to the capital account of the old partner. In 1935 when a further partner was admitted, £10,406 10s 1d in respect of unclaimed balances between 1922 and 1928 was transferred partly to the current accounts and partly to the capital accounts of the former partners. A partnership deed in 1936 provided that such liability as subsisted in respect of those sums should be assumed by the partnership and that such unclaimed balances as first arose six years before the taking of each annual account should be transferred at such account to the credit of the partners in accordance with their shares in the partnership. The partnership deed further provided that all liability in respect of the unpaid amounts should be borne by the partnership.

36. Sir Wilfrid Greene MR noted that the Statute of Limitation had not started to run in respect of the balances. Therefore, the taxpayer was still obliged to make payment to a customer at any time if requested (at 298):

> Many of those balances have remained unclaimed for a considerable number of years, but the Solicitor-General quite properly admitted that the vendors in question were entitled to claim payment of their money at any time, unaffected by the Statute of Limitation, which has not yet begun to run, owing to the absence of any written order as required by the conditions. We are dealing, therefore, with obligations which, as a matter of law, are existing obligations, which the firm can be called on to perform at any moment. That is a matter not without importance in the examination of this case.

37. Sir Wilfrid Greene MR went on to further explain the effect of the agreements between the partners (at 300). In particular, he noted that the agreements did not affect the legal position between the clients and the partnership. Rather the agreements related to the accounting treatment of the unclaimed amounts as well as what was in effect an indemnity between the partners and the partnership in relation to the amounts:

> Pausing there for a moment, and eliminating, for the purpose of simplicity, the changes in the partnership agreement, it is of the utmost importance in this case to appreciate the real nature of what was being done. I say that because, in the arguments addressed to us on behalf of the Crown, various metaphorical expressions were used, such as "holding a sum," "changing the capacity in which a sum is held," "turning a sum into an asset," and so forth—expressions which, to my mind, are both inaccurate and misleading. What happened was that the partnership, being indebted to outside persons; in respect of sums which it had received, and which had passed into the general mass of its assets, and having carried in its balance-sheet a proper liability item to express that liability, decided at a certain point, and on certain principles laid down, that that liability item should be written down and diminished. That is what happened in 1921, in 1934, and year by year after the provisions of the new partnership agreement came into operation—merely the alteration of a debit item in the balance-sheet by eliminating from it certain liabilities which had previously gone to make it up. If that matter had stayed there, the only result on the balance-sheet would have been to increase the credit balance. It would have shown a greater surplus of assets over liabilities than it had shown prior to that writing down. It so happened that, for domestic reasons of their own, the partners, instead of leaving the matter in that way, with an increased credit balance, decided that that increase in the credit balance should be carried in the balance sheet to the partners' accounts. That does not alter the reality of the position one jot. **The true position is—and I repeat it, because it is only when that is appreciated that what I, with respect, conceive to be the fallacies underlying the Crown's argument are perceived—that the only thing which was done on these occasions was the elimination from the liabilities side of the balance-sheet of something which had previously appeared as a liability therein**.
>
> [Emphasis added]

38. It was generally agreed between the parties that the money was not a trading receipt at the time it was received. However, it was argued that the amounts became trading receipts at the time the partners treated the amounts as their own. Sir Wilfrid Greene MR rejected this argument, finding that the writing down of the amount in the balance sheet did not convert that amount to income (at 301):

> It might be more convenient to deal with Mr Hills's argument first, because that is the one which starts off with the perfectly clear admission that the money, when received from the purchasers, was not a trading receipt. That proposition, I should have thought, was, in any case, quite incontestable. **The money received was money which had not got any profit-making quality about it. It was money which, in a business sense, was the clients' money, and nobody else's**. It

was money for which Messrs Tattersall were liable to account to the clients, and the fact that Messrs Tattersall paid it into their own account, as they clearly did, and the fact that it remained among their assets until paid out, do not alter that circumstance. It would have been, for income tax purposes, in my judgment, entirely improper to have brought those receipts into the account at all for the purpose of ascertaining the balance of profits and gains. Indeed, as I have said, the Crown did not suggest that that would have been proper. What was said, however, was this. Mr Hills's argument was to the effect that, although they were not trading receipts at the moment of receipt, they had at that moment the potentiality of becoming trading receipts. That proposition involves a view of income tax law in which I can discover no merit except that of novelty. **I invited Mr Hills to point to any authority which in any way supported the proposition that a receipt which at the time of its receipt was not a trading receipt could by some subsequent operation ex post facto be turned into a trading receipt—not, be it observed, as at the date of receipt, but as at the date of the subsequent operation. It seems to me, with all respect to that argument, that it is based on a complete misapprehension of what is meant by a trading receipt in income tax law. No case has been cited to us in which anything like that proposition appears. It seems to me that the quality and nature of a receipt for income tax purposes is fixed once and for all when it is received**. What the partners did in this case, as I have said, was to decide among themselves that what they had previously regarded as a liability of the firm they would not, for practical reasons, regard as a liability. That does not mean, however, that at that moment they received something, nor does it mean that at that moment they imprinted on some existing asset a quality different from that which it had possessed before. There was no existing asset at all at that time. All that they did, as I have already pointed out, was to write down a liability item in their balance-sheet, and how by effecting that operation it can be said that a sum received years ago has been converted into something which it never was is a thing which, with all respect, passes my comprehension.

[Emphasis added]

39. *Jay's the Jewellers Ltd v IRC* [1947] 2 All ER 762 (KB) involved the tax treatment of proceeds from the sale of pledged property. The Pawnbrokers Act 1872 required a pawnbroker to hold a pledge for 12 months and 7 days. If the pledged article had not been redeemed by then and the loan was no more than 10s, the pledge became the property of the pawnbroker, who could sell it and keep the proceeds. If the loan exceeded 10s, the pawnbroker was entitled to sell the pledged article by auction and to take the amount of the loan, the interest due and the cost of the sale out of the amount realised. Subject to the terms of any special contract, which were permitted if the loan exceeded 40s, at any time within three years of the sale the pledgor had the right to inspect the pawnbroker's books and demand payment of the surplus. After three years, the pledgor lost that right and the surplus became the property of the pawnbroker. Special contracts entered into by pawnbrokers with pledgors sometimes incorporated the three-year period, but in others the pledgor's rights to redeem were barred only by the ordinary period of limitation, six years.

40. The issue was whether the proceeds from the sales were subject to excess profits tax. The court held that, as a matter of law, the surpluses when received were not the taxpayers' monies at all; they belonged to their clients. Based on *Tattersall*, the court found that the surpluses were not trading receipts in the year that they were received. The court then went on to consider whether a surplus could be treated as a trade receipt in a later year when the taxpayer became entitled to retain it.

41. The court held that a new asset was created automatically by operation of law at the end of the three years (in the case of most of the loans) and common sense would seem to demand that that should be entered in the profit and loss account for the year and be treated as taxable. The court distinguished the decision in *Tattersall* as follows (at 766):

> It is, however, argued that I cannot give effect to that view because of *Tattersall's* case. Is there anything in *Tattersall's* case to indicate that that view is wrong? In that case there had been no change whatever in the character and nature of the money held. The Statute of Limitations had not commenced to run, and the court was dealing merely with the effect of a change in the method in which these sums were dealt with in the company's books.
>
> …
>
> Here the position is different. Here, at the end of three years, the money in question, the three-year-old surplus, did attain a totally different quality. I think there was then a definite trade receipt. At the end of the three years a new asset came into existence, an asset which had arisen out of a trade transaction.

42. The court then considered whether the position should be different for pledges that were subject only to the application of a limitation period. The same conclusion was held to apply (at 767):

> The position is somewhat different as to pledges for over £10, because the only change which takes place at the end of six years is that the customer's remedy

> is barred, but, from the business point of view, I think, it ought to be treated as the same. In practice those amounts would be properly dealt with by the taxpayers as their own. They could not get into difficulties by so doing. They cannot be called on to pay. I do not think any distinction ought to be drawn between the three-yearly surpluses and the six-yearly surpluses, and I am not prepared to differ from the view held by the Special Commissioners. Therefore, both appeals will fail.

43. In holding that the unclaimed deposits were income of the taxpayer in the year received, *Prices Tailors* (see para 28) distinguished *Tattersall* and *Jay's the Jewellers* on the basis that, in those cases, the amounts in question did not belong to the taxpayers (at the time they were received) (at 235):

> In *Morley v Tattersall*, the vendors' unclaimed balances, in the hands of a firm of auctioneers, of proceeds of sale of horses were held not to be trading receipts; and in *Jay's, The Jewellers Ltd v Inland Revenue Comrs; Inland Revenue Comrs v Jay's, The Jewellers Ltd*, a pawner's unclaimed balance in the hands of a pawnbroker of the proceeds of sale of an unredeemed pledge, after satisfying the amounts due under the pledge, was held not to be a trading receipt until the pawner's claim was statute-barred. **In these cases, the balances in the traders' hands were not theirs at all but were held for others, and this fact is fundamental to the decisions. The traders had no beneficial interest in them at the relevant time, and, although it was because they were traders that they received them, they were not receipts of their trade at all**.
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> [Emphasis added]

44. The taxpayer in *Pertemps Recruitment Partnership Ltd v HMRC* [2010] UKFTT 218 (TC) carried on business as a recruitment agent. Sometimes it would receive overpayments from customers (that is, payments of amounts that were not owing). Where these amounts could not be refunded or applied against a later liability, the taxpayer kept the payments. The court found that receipt of mistaken payments was an inevitable incident of the taxpayer's business. The court further found that:
    - when the overpayments were deposited in the taxpayer's bank account, the taxpayer did not know that they represented an overpayment;
    - the taxpayer treated the overpayments as its own money (that is, the overpayments were not kept in a separate account;
    - the taxpayer did not hold the mistaken payments on trust for the customer (*Tattersall* and *Jay's the Jewellers* were distinguished on this basis);
    - no limitation period would likely apply to the overpayments; and
    - the amounts paid belonged to the taxpayer unless the customer made a successful claim in restitution, or the claim was settled by agreement.

45. The court held that the payments were profits from the taxpayer's trade in the year that they were received. The fact the customers had an entitlement to claim the money back did not change this. The Tribunal Judge stated (at 43–44):

> HMRC's submission, with which we agree, is that an [sic] mistaken payment for services has the same characteristic in the hands of the recipient trader as a payment made not in error – **if the payment is made because the customer makes a mistake about owing something for services or for a trading transaction, the mistaken payment accrues from the trade of the recipient**. This is entirely consistent with the manner in which Pertemps operates its business. At the time payments are deposited into the Pertemps' bank account, it does not distinguish between overpayments and other receipts. Indeed it could not – as Pertemps banks payments before they are allocated to invoices on ledgers. Even if a receipt is eventually determined to be an overpayment, it will often be applied against other invoices rendered to the customer.
>
> … HMRC submit, and we agree, that **the overpayments are a natural consequence of the efficient and lawful way in which Pertemps conducts its business**, and that these processes will mean that **sometimes it makes more money from the supply of its services than it had anticipated**. In doing so, it has supplemented its trading profits, and the receipt is a trading receipt.
>
> [Emphasis added]

46. In *Gower Chemicals v HMRC* [2008] UKSPC 713 (SpC) the taxpayer carried on business selling chemicals. Chemicals were sold in reusable containers. Customers paid a refundable deposit for a container that remained the property of the taxpayer. When a container was returned in good condition and in a reasonable time, the appellant would issue a credit note or refund the deposit. Sometimes containers were returned but the customer never took the credit or refund. At issue was whether the unclaimed deposits were trading income. The Special Commissioners found that the deposits belonged to the taxpayer as soon as they were received and should be brought into income at that point. This was because the taxpayer knew that in the course of its business, 20% of the deposits would not have to be repaid. Special Commissioner, Dr John Avery Jones stated (at 7):

> The issue for me turns primarily on the nature of the receipt of the deposit by the Appellant. The Appellant knows that about 20 per cent of deposits will not have to be repaid. In my view this makes it impossible to say that the Appellant is merely holding the deposit for the customer. The straightforward analysis is that the deposit is a trading receipt just as the payment for the goods is a trading receipt but with the difference that about 80 per cent of the deposits will have to be repaid, for which it is right to make a provision. While I agree that factually this distinguishes this case from *Prices Tailors*, I do not consider that this changes anything. In that case the deposit was security for the completion of the garment that the customer had ordered. Deposits were in fact repaid to customers who did not accept the garment even though there was not contractual obligation to do so. The decision relied on Smart v *Lincolnshire Sugar Co* 20 TC 643 in which there was a contractual right to repayment of the deposit if a contingency occurred. The need for a provision for this was discussed in the case and it is recorded in *Prices Tailors* that the same point was raised. In my view the Appellant's past accounting treatment was correct. The deposit belongs to the Appellant as soon as it is received and should be brought into income at that point.

Summary of principles from the United Kingdom cases

47. It may appear that the reasoning in the UK cases is not always consistent. For example, as noted above, in *Tattersall*, the court found that the nature of a receipt for income tax purposes is fixed at the time it is received. However, the court in *Jay's the Jewellers* took the view that a receipt could become income at a later date where its nature was changed by the operation of law.

48. Notwithstanding the apparent inconsistencies, it is considered that the above cases can all be reconciled. Where a later case has reached a different view than an earlier case, the later case has refined and/or expanded the principles set out in the earlier case and adapted them to the facts at issue. Consequently, the following principles can be taken from the above cases:

- Where an amount is no longer liable to be repaid (whether by virtue of contractual terms, limitation or other statute), then it will become income (if it was not previously) (*Jay's the Jewellers*).
- Just because an amount may be subject to repayment does not mean that the amount cannot be income (*Lincolnshire Sugar, Pertemps*).
- When an amount is held on trust for a third party, it will not be income (*Tattersall*).
- Changing the accounting treatment of an amount will not, by itself, make that amount income (*Tattersall*).
- Unsolicited overpayments that a taxpayer treats as their own money belong to the taxpayer unless the customer makes a successful claim (*Pertemps*).
- Unsolicited overpayments and unclaimed refundable deposits are income in the year they are received (*Pertemps, Gower Chemicals*).

Application to unclaimed amounts of $100 or less in New Zealand

49. As noted above, for an amount to be derived it must be received beneficially by the taxpayer (ie, received free from legal impediments to the taxpayer dealing with the money in its own interests). In the context of unclaimed money, this is most likely to give rise to a question of whether an amount is held on trust or not. Therefore, the treatment of money held on trust is considered below.

Money held on trust

50. Most unclaimed money will not be held on trust. For example, where a customer has overpaid an account, the overpayment will not normally be held on trust by the holder. The relationship between a customer and a business will normally be a contractual one. Similarly, the relationship between a bank and depositor will normally be one of debtor-and-creditor and not trust (see *DFC New Zealand Ltd v Goddard* [1992] 2 NZLR 445). However, in certain circumstances, unclaimed money may be held on trust by the holder. Examples include funds held in a real estate agent's trust account or a solicitor's trust account.

51. A trust will often (but not always) be evidenced by the existence of a trust deed. A trust will be present where the holder holds the unclaimed money for the benefit of a third party (the "owner" for unclaimed money purposes) and cannot deal with the money in their own interests. Therefore, to determine whether an amount is held on trust, it is necessary to look at the terms on which the money was originally paid and on which it is currently held.

52. As noted above, money held on trust is unlikely to be able to be applied by the holder for their own benefit without breaching the terms of the trust. Consequently, the proviso to s 4(1) of the UMA 1971 will not be satisfied and the amounts will be unclaimed money. This is also likely to be the case for other amounts that are not received beneficially by a taxpayer. If s 4(1) is not satisfied, then the amounts cannot be income as they will be subject to the UMA 1971 and must ultimately be paid to Inland Revenue. If, on the other hand, the money is in fact applied by the holder for its own benefit, it is unlikely that the holder will be able to

show that the money is held on trust (or otherwise not received beneficially).

53. The conclusion that money held on trust cannot be income of the holder is consistent with the case law considered above. None of the cases found that money held on trust could be income of the holder.

54. However, if money ceases to be held on trust (for example, by virtue of the terms of the trust or the application of a statutory provision) and the holder applies it for their own benefit, then s 4(1) of the UMA 1971 could apply and the amount could become income of the holder. In this case, the amount should be treated the same as amounts not held on trust.

Money not held on trust

55. At issue is when (if at all) amounts of unclaimed money applied by the holder for their own benefit will be derived by the holder. As noted above, it is assumed that the amounts are received by the holder in the ordinary course of their business.

56. New Zealand case law on derivation has followed the Australian decision of *Arthur Murray*. Therefore, in New Zealand, income will be derived when what has taken place is enough to satisfy the general understanding among practical business people of what is derivation of income. The UK case law may be of assistance in determining this. However, that case law was not considering the meaning of derivation so care needs to be taken when applying the decisions in a New Zealand context.

57. In the case of unclaimed money, it could be argued that derivation occurs on receipt or at some point following receipt, or that derivation never occurs. As no New Zealand case law is directly on point, it is necessary to consider the principles taken from the case law to determine how a court would apply them to resolve this issue.

58. Where a contractual or statutory provision (such as the Limitation Act 1950 or Limitation Act 2010) applies so that the holder of money will no longer be required to repay it if requested by the owner, then the amount will be income. This is consistent with the UK case law. It is also consistent with *Arthur Murray* and the New Zealand derivation cases, because the holder has to do nothing further to earn the amount and there is no possibility that the amount will be repayable. However, in many cases of unclaimed money, it is unlikely that the relevant Limitation Act will apply and there will be no contractual terms limiting the holder's liability to repay. Therefore, it is necessary to consider whether these amounts could be income even though they are still subject to the possibility of repayment.

59. As noted above, that an amount may be subject to repayment will not necessarily prevent it being income (see, for example, *Lincolnshire Sugar, Pertemps, Gower Chemicals, Case N30, Bowcock*).

60. Pertemps is the decision that is closest to the facts being considered. It could be argued that *Pertemps* should be applied in New Zealand, which would lead to the conclusion that (at least in the case of overpayments) the relevant amounts are income when they are received. However, this is not considered the correct approach for two reasons. First, in New Zealand the UMA 1971 potentially imposes some statutory obligations in respect of the amounts until the proviso to s 4(1) applies to exclude the amount from being unclaimed money. Secondly, *Pertemps* is arguably inconsistent with the approach taken in *Arthur Murray* and the subsequent New Zealand cases. This is discussed in more detail below. In summary, it is considered that *Pertemps* provides support for the proposition that the amounts of unclaimed money are in the nature of income. However, it is not considered good authority in New Zealand for **when** that income is derived.

61. It could be argued that the fact (in many cases) the holder will always be liable to repay the relevant amounts to the owner (if asked) means applying *Arthur Murray* would lead to the conclusion that the amounts would never be derived. However, it is considered that the principles from *Arthur Murray* need to be interpreted in the context of the facts in that decision. *Arthur Murray* was considering prepaid services. This meant its analysis was focused on establishing when an amount would be "earned" where there was a future requirement to perform services on request. No consideration was given to what the position would be where there was no (or no longer an) obligation to perform any services. *Case N30* expanded the scope of the principles from *Arthur Murray*. In *Case N30* income was held to be derived even though the services paid for had not been performed. The earning process was found to be complete once it was probable that the service would not be required to be performed.

62. In the context of an amount of unclaimed money, that amount will not be "earned" in the sense of goods or services being provided for it. However, it is an amount that is received in the ordinary course of the taxpayer's business and it is being treated by the taxpayer as its own money (in the sense of having

been applied for the holder's use). As nothing further needs to be done by the taxpayer to earn the money, the only thing stopping it being derived is the fact it is subject to the contingency of repayment. As time passes, that contingency will become more remote.

63. Once it is probable that the unclaimed amount will not need to be repaid, it should be treated as income. The "probable" threshold is based on the test used in *Case N30*. A different standard may be more appropriate. For example, it could be argued that it is sufficient for an amount to be treated as income where it is "unlikely" that it will need to be repaid. However, on balance, it is considered that the case law better supports the slightly higher "probable" threshold. Practically, there may not be much difference in any event.

64. When it is probable that an amount will not be repaid will depend on the particular business. Business records and accounting treatment are likely to be relevant to determining this. For example, if business records show that once an amount is applied for the benefit of the holder under the proviso to s 4(1) of the UMA 1971, it is probable that it will not be paid back, then this would suggest that the amount should be returned as income at that time. If, on the other hand, the business records show that even after 10 years, customers still successfully request the return of unclaimed amounts (on more than just isolated occasions), then this may suggest that the amounts should not yet be treated as income. This will be a question of fact to be determined in each case. It is not possible to provide more prescriptive factors.

65. In summary, an unclaimed amount will be derived when it:

- has been applied by the holder for its own benefit (that is, the proviso to s 4(1) of the UMA 1971 applies); and
- is probable that the amount will not have to be repaid (which would include situations (described above) when the amount is not legally recoverable; for example, under a contractual term or the Limitation Act).

Amounts subsequently repaid to owners

66. Section DA 1 sets out the general permission for deductibility. In particular, s DA 1(b) allows a deduction for an amount of expenditure to the extent to which it is incurred in the course of carrying on a business for the purpose of deriving assessable or excluded income.

67. The Rulings apply to amounts of unclaimed money that are received by holders in the ordinary course of their business. The Commissioner's view is that repayment of these amounts to their owners is also undertaken in the course of the holder's business. Consequently, if a holder subsequently returns an amount that has previously been recognised as income, the holder will be entitled to a deduction under s DA 1(b).

Conclusions

68. For amounts of unclaimed money of $100 or less, while money is held on trust and cannot be (and has not been) applied by the holder for their own benefit (or for the benefit of any other person or for any purpose or object) it cannot be income of the holder.

69. An unclaimed amount (of $100 or less) not held on trust will be derived when it:

- has been applied by the holder for its own benefit (that is, the proviso to s 4(1) of the UMA 1971 applies); and
- is probable that the amount will not have to be repaid (which would include situations when the amount is not legally recoverable; for example, under a contractual term or the Limitation Act).

70. When it is probable that an amount will not be repaid will depend on the particular business. Business records and accounting treatment are likely to be relevant to determining this.

71. If a holder has recognised a previously unclaimed amount as income and subsequently returns that amount to the owner, the holder will be entitled to a deduction under s DA 1(b).

Example: Unclaimed money not held on trust

72. The following example is included to assist in explaining the application of the law.

73. Supaphone Ltd is carrying on business as a telecommunications company. Many of Supaphone's clients pay their accounts by monthly automatic payment. Sometimes when clients close their accounts with Supaphone, they forget to cancel their automatic payments straight away. This results in overpayments to Supaphone. Supaphone attempts to contact customers to return these overpayments, but these customers are often impossible to locate. Supaphone also receives payment by cheque. Sometimes, despite its best attempts, Supaphone cannot match the cheque received with a particular customer's account. In both situations, the amounts received are subject to the UMA 1971.

74. Where unclaimed amounts are $100 or less, Supaphone applies them to its business (within the applicable timeframes) under the proviso to s 4(1) of the UMA 1971. At this time, the amounts are no longer subject to the UMA 1971.

75. Supaphone's business records show that over the past 10 years repayment requests are made for 50% of unclaimed amounts within four years of receipt. However, in the past 10 years only two people have requested the return of unclaimed money more than four years after it was received. Therefore, after four years it is probable that the amount will not have to be repaid.

76. Supaphone asks whether (and when) the unclaimed amounts of $100 or less are business income under s CB 1.

77. The unclaimed amounts are not held by Supaphone on trust. Therefore, the amounts will be income under s CB 1 when they are derived (assuming that no other timing regime applies). The amounts will be derived when:

- Supaphone applies the amounts to its business under the proviso to s 4(1) of the UMA 1971 (which occurs around six years after receipt); and
- it is probable that Supaphone will not have to repay the amounts (in this case four years after receipt).

78. As the later of these events is the application of the amounts under the proviso to s 4(1), the amounts are derived and should be returned as business income when Supaphone applies these amounts to its business.

References

Subject references
Business income; Derivation; Unclaimed money
Legislative references
Income Tax Act 2007, s CB 1
Limitation Act 1950
Limitation Act 2010
Unclaimed Money Act 1971, ss 4, 5, 6, 7 and 8
Case references
A Elson (Inspector of Taxes) v Prices Tailors Ltd [1963] 1 All ER 231 (ChD)
Arthur Murray (NSW) Pty Ltd v FCT (1965) 114 CLR 314
Bowcock v CIR (1981) 5 NZTC 61,062 (HC)
Case N30 (1991) 13 NZTC 3,266 (TRA)
CIR v Molloy (1990) 12 NZTC 7,146 (HC)
Gower Chemicals v HMRC [2008] UKSPC 713 (SpC)
Jay's the Jewellers Ltd v IRC [1947] 2 All ER 762 (KB)
Lincolnshire Sugar Co Ltd (in liquidation) v Smart (HMIT) [1937] 1 All ER 413 (HL)
Morley (Inspector of Taxes) v Tattersall [1938] 3 All ER 296 (CA)
Pertemps Recruitment Partnership Ltd v HMRC [2010] UKFTT 218 (TC)
Other references
'Inland Revenue Technical Rulings – now limited to historic value' *Tax Information Bulletin* Vol 10, No 9 (September 1998)

APPENDIX – LEGISLATION

Income Tax Act 2007

1. 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.

Unclaimed Money Act 1971

2. Section 4 of the Unclaimed Money Act 1971 provides:

Unclaimed money

(1) Subject to this section, unclaimed money shall consist of—

(a) money, including the interest or any amount in the nature of interest thereon, deposited with any holder so as to bear interest for a fixed term, which has been in the possession of the holder for the period of 6 years immediately following the date of expiry of the term:

(b) money, including the interest or any amount in the nature of interest thereon, deposited with any holder so as to bear interest—

(i) without limitation of time; or

(ii) for a fixed term where, on the expiry of the fixed term, the money, if it is not withdrawn by the customer, is to be treated as reinvested,—

where in either case the customer has not operated on the account for a period of 25 years, whether by deposit, or withdrawal, or instruction in writing:

(c) money deposited upon current account or otherwise with any holder and not bearing interest, where—

(i) in any case where the holder is a savings bank, the customer has not operated on the account for a period of 25 years, whether by deposit, or withdrawal, or instruction in writing; and

(ii) in any other case, the customer has not operated on the account for a period of 6 years, whether by deposit, or withdrawal, or instruction in writing:

(d) money payable or distributable on or in consequence of the maturity of a policy of life assurance, being money which has been in the possession of any holder for the period of 6 years immediately succeeding the date on which—

(i) the policy matured otherwise than by death; or

(ii) the holder first had reason to suppose that the policy has matured by death, whether such death has been legally proved or not,—

whichever date is the earlier, and notwithstanding that by the terms of the policy the money is not payable or distributable except on proof of death, or on proof of age or any other collateral matter:

(e) any other money, of any kind whatsoever, which has been owing by any holder for the period of 6 years immediately following the date on which the money has become payable by the holder:

provided that money of any of the kinds referred to in this subsection shall cease to be unclaimed money where—

(i) in respect of any one owner it does not exceed $100 in total; and

(ii) before the 1st day of June next succeeding the end of the period of 6 years or, as the case may be, 25 years specified in this subsection, that unclaimed money is, without limiting any claim any owner may have thereto, applied by the holder for his own benefit or for the benefit of any other person or for any purpose or object.

(2) Unclaimed money shall not include—

(a) any dividends, not being dividends payable by a mutual association in relation to money deposited with the association, payable by a company to any of its shareholders:

(b) any rebate payable by a mutual association (other than a holder of the kind referred to in paragraph (f) of subsection (1) of section 5 of this Act) to any of its members in relation to the trading transactions of the member with the association, not being a rebate payable in relation to money deposited with the association:

(c) any benefits payable from any pension or superannuation fund.

(3) Where a holder has ceased to carry on business or has died, and the holder, or, as the case may be, his personal representative, has for a period of 6 months or more immediately succeeding the date of that cessation or death been in possession of or owed money which has remained unclaimed and—

(a) which would become unclaimed money when the period referred to in the appropriate paragraph of subsection (1) of this section had expired if the money had remained unclaimed; or

(b) which would have so become unclaimed money if it were not money of any of the kinds referred to in subsection (2) of this section,—

the holder or that personal representative may, if he thinks fit, pay the money to the Commissioner and furnish to the Commissioner particulars of the payment and of the person on whose behalf the money was held or to whom it was owed; and thereupon that money shall be deemed to be unclaimed money, and the provisions of this Act, as far as they are applicable, shall apply accordingly:

provided that this subsection shall not apply to any money of the kind referred to in section 330 of the Companies Act 1955.

(4) In subsection (2) of this section the expression **mutual association** means any body or association of persons, whether incorporated or not, which enters into transactions of a mutual character with its members, whether or not it also enters into transactions with other persons.

3. Section 5 of the Unclaimed Money Act 1971 provides:

Holder

(1) This Act shall apply to unclaimed money held or owing by the following holders:

(a) any company incorporated in New Zealand and any liquidator or receiver of any such company:

(b) any company incorporated out of New Zealand and carrying on business in New Zealand, and any liquidator or receiver of any such company:

(c) any bank, including a savings bank, carrying on business in New Zealand:

(d) any building society within the meaning of the Building Societies Act 1965:

(e) any person, firm, body, or institution carrying on the business of borrowing and lending money in New Zealand, in respect of money borrowed:

(f) any insurance office or company carrying on business in New Zealand, including the Government Life Insurance Corporation:

(g) any auctioneer within the meaning of the Auctioneers Act 1928, whether or not a company, in respect of any balance of proceeds of any auction sale:

(h) any agent within the meaning of the Real Estate Agents Act 2008, whether or not a company, in respect of money held in a trust account:

(ha) any conveyancing practitioner within the meaning of the Lawyers and Conveyancers Act 2006, in respect of money held in a trust account:

(i) any sharebroker within the meaning of the Sharebrokers Act 1908, whether or not a company, in respect of money held on behalf of clients:

(j) any chartered accountant (within the meaning of section 19 of the New Zealand Institute of Chartered Accountants Act 1996) in respect of money held on behalf of clients:

(k) any motor vehicle trader within the meaning of the Motor Vehicle Sales Act 2003, whether or not a company, for money held on behalf of any person for whom the trader has acted as agent in the course of carrying on the business of motor vehicle trading.

(2) Any person, firm, body, or institution may elect to be the holder in respect of such money held or owing by him or it as he or it thinks fit, not being—

(a) unclaimed money in respect of which he or it is the holder under subsection (1) of this section; or

(b) except where subsection (3) of section 4 of this Act applies, money to which subsection (2) of that section applies;—

and in that case he or it shall be deemed to be the holder in respect of that money.

4. Section 6 of the Unclaimed Money Act 1971 provides:

Register to be kept

(1) Every holder shall, on the 1st day of June in each year, enter in an alphabetical register, to be kept at the head or principal office in New Zealand of the holder, in the form prescribed in the Schedule to this Act, particulars of unclaimed money arising on or after the 1st day of June in the preceding year; and from and after the 8th day of June in each year that register shall be open to the inspection of all persons at that head or principal office during the hours within which the ordinary business of the holder is transacted, on payment of such fee as may be determined by the holder, but not exceeding 50 cents:

provided that—

(a) on ceasing to carry on business in New Zealand a holder shall deposit the register in the custody of the Registrar of the District Court nearest to the place where that register was theretofore kept:

(b) any holder may at any time so deposit any book or part of the register in which no entry has been made for a period of not less than 6 years immediately preceding the date of that deposit.

(2) Nothing in this section shall apply to any unclaimed money in respect of which special provisions are made by or under any other Act, or to any unclaimed money which, pursuant to the proviso to subsection (1) of section 4 of this Act, ceases to be unclaimed money.

5. Section 7 of the Unclaimed Money Act 1971 provides:

Holder to notify Commissioner and owners of entries in register of unclaimed money

(1) Not later than the 30th day of June in each year, every holder shall, by letter addressed to the last known place of business or abode of the owner, post to every owner in respect of whom an entry as the owner of unclaimed money was required to be made on the 1st day of that month in the register kept by the holder pursuant to section 6 of this Act, a notice specifying the amount of that money and the fact that it is entered in the register as unclaimed money, and the holder shall thereupon enter in that register the date of posting of the notice.

(2) Not later than the 30th day of September in each year, every holder shall furnish to the Commissioner a copy of every entry made, on or after the 1st day of June in that year, in the register kept by the holder pursuant to section 6 of this Act, and shall indicate to the Commissioner which, if any, of the unclaimed money in respect of which the entry was so made, has, on or after that 1st day of June, been paid to the owner thereof.

(3) Nothing in this section shall apply to any unclaimed money in respect of which special provisions are made by or under any other Act.

6. Section 8 of the Unclaimed Money Act 1971 provides:

Payment of unclaimed money to Commissioner

(1) All unclaimed money arising in any year ending with the 31st day of May which has not, before the next succeeding 30th day of September, been paid by a holder to the owner thereof, and in respect of which no person has before that 30th day of September established a valid claim, shall be paid, on or before the next succeeding 31st day of October, by the holder to the Commissioner:

provided that this subsection shall not apply to any unclaimed money in respect of which special provisions in relation to payment to the Commissioner are made by this Act or in respect of which special provisions are made by or under any other Act.

(2) All money payable to the Commissioner in accordance with this section shall be recoverable by the Commissioner on behalf of the Crown by action in his official name in any Court of competent jurisdiction against the holder as a debt due to the Crown.

(3) All unclaimed money received by the Commissioner under this or any other Act shall be paid into the Crown Bank Account.

(4) Where unclaimed money is paid by a holder to the Commissioner in accordance with this Act, the holder shall thereafter be relieved of all further liability to any claimant in respect of the money so paid.

7. Section 13 of the Unclaimed Money Act 1971 provides:

Offences

(1) Every person commits an offence, and is liable on summary conviction to a fine not exceeding $500, who wilfully or negligently—

(a) being a holder, fails to comply with any provision of section 6, section 7, subsection (1) of section 8, or section 10 of this Act, or with any condition on which the Commissioner has granted exemption under section 9 of this Act; or

(b) being a director, manager, secretary, or other officer of the holder, authorises or permits that failure to comply.

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 DEP84: DEPRECIATION RATE FOR PRINTING MACHINES (AUTOMATED INKJET FLATBED)

Note to Determination DEP84

The Commissioner has considered a general depreciation rate for printing machines that use integrated technologies that consist of a screen printer type base (base printing machine) with a multiple-head inkjet print shuttle (digital print head) to form a new hybrid machine.

Although these machines are manufactured as one unit, the two key integrated components utilise different technology, therefore the lives of the base printing machine and digital print head could be different. A weighted average calculation has been applied by the Commissioner to arrive at an estimated useful life for the asset as a whole. The weighted average calculation more accurately reflects the economic life of the asset and recognises that some components contribute unequally to the life of an asset.

The general depreciation rate applies to these printing machines only. Other machinery that can be linked to these printing machines (examples being, dryer and in-line stacking machines) appear to be quite conventional and are covered by other general depreciation rates applicable to these other machines.

GENERAL DEPRECIATION DETERMINATION DEP84

This determination may be cited as "Determination DEP84: Printing machines (automated inkjet flatbed).

This determination applies for the 2014 and subsequent income years.

1. Application

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

2. Determination

Pursuant to section 91AAF of the Tax Administration Act 1994 I set in this determination the economic rate to apply to the kind of items of depreciable property listed in the table below by:

- adding into the "Packaging (excluding plastic packaging)" and "Printing and photographic" industry categories, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Printing machines (automated inkjet flatbed)	10	20	13.5

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 by me on the 30th day of May 2013.

Vanessa Montgomery
(Acting) LTS Manager, Technical Standards

PROVISIONAL DEPRECIATION DETERMINATION PROV25: STABILISED TURF SYSTEMS

Note to Determination PROV25

The Commissioner has set provisional depreciation rates for stabilised turf systems by adding new asset classes to the "Leisure" industry category.

Stabilised turf systems comprise the playing surfaces of some sports stadiums. The turf systems are made up of the playing surface, infill, base, drainage, and watering system. The turf systems vary in that one involves synthetic grass and the other synthetic tufts and plastic mesh through which natural grass grows. Ground preparation work, other than trenches cut to facilitate the installation of drainage pipes, is not depreciable as it relates to the land.

As the determination shows, the stabilised turf system consists of a number of components that have different useful lives.

PROVISIONAL DEPRECIATION DETERMINATION PROV25

1. Application

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

This determination applies from the 2011–12 and subsequent income years.

2. Determination

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

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

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Synthetic Grass, infill and shock attenuation pads	10	20	13.5
Stabilised Turf System Matrix and infill	10	20	13.5
Base Sand, Gravel and Drainage (including drainage trenches but not including land contouring)	20	10	7.5
Watering System	20	10	7.5

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 by me on the 5th day of June 2013.

Rob Wells
LTS Manager, Technical Standards

QUESTIONS WE'VE BEEN ASKED

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

QB 13/02: INCOME TAX – DETERMINING THE "SUBSCRIPTIONS" AMOUNT FOR AN AMALGAMATED COMPANY UNDER THE AVAILABLE SUBSCRIBED CAPITAL RULES

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

This Question We've Been Asked is about ss CD 43(2)(b) and CD 43(15).

Question

1. We have been asked whether the "subscriptions" amount in the available subscribed capital (ASC) formula in s CD 43 excludes consideration received for shares issued by an amalgamated company between 30 June 1994 and the date of the amalgamation through the operation of s CD 43(15)(a)(iii).

Answer

2. The consideration received for shares issued by an amalgamated company between 30 June 1994 and the date of the amalgamation is not excluded from the amalgamated company's subscriptions amount by s CD 43(15)(a)(iii).
3. Section CD 43(15)(a)(iii) operates to prevent the double-counting of an amalgamated company's "subscriptions". For an amalgamated company, as with any other company, it is necessary to determine the consideration received for shares issued under s CD 43(2)(b). Section CD 43(15) provides that the ASC of an amalgamated company "includes" the ASC of all amalgamating companies (except the amalgamated company under s CD 43(15)(a)(iii)). Therefore, s CD 43(15) adds an additional amount to the "subscriptions" amount of an amalgamated company determined under s CD 43(2)(b).
4. The purpose of the ASC formula is to determine the amount that shareholders have paid into a company as capital when subscribing for shares. The ASC of a company can be returned to shareholders tax-free in certain circumstances rather than being treated as a dividend.

Explanation

5. This Question We've Been Asked clarifies the effect of s CD 43(15)(a)(iii). It has been suggested that this subparagraph might exclude the ASC of the amalgamated company from being taken into account as "subscriptions" in the ASC formula.

Section CD 43(2)(b)

6. Subsections (1) and (2)(b) of s CD 43 provide:

> **CD 43 Available subscribed capital (ASC) amount**
>
> *Formula for calculating amount of available subscribed capital*
>
> (1) For a share (the share) in a company at any relevant time (the calculation time), the amount of available subscribed capital is calculated using the formula—
>
> 1 July 1994 balance + subscriptions − returns − look-through company returns.
>
> *Definition of items in formula*
>
> (2) In the formula in subsection (1),—
>
> …
>
> (b) subscriptions, subject to subsections (6) to (21), is the total amount of consideration that the company received, after 30 June 1994 and before the calculation time, for the issue of shares of the same class (the class) as the share, ignoring section HB 1 (Look-through companies are transparent):

7. Section CD 43(2)(b) provides that the subscriptions amount of a company is the total amount of consideration that the company received after 30 June 1994 and before the calculation time for the issue of shares of the same class.
8. Section CD 43(2)(b) is subject to s CD 43(15) when determining the ASC of an amalgamated company. The phrase "subject to" indicates that one provision qualifies, modifies or changes another. The phrase also indicates which provision is to prevail in the event of a conflict: *C & J Clark Ltd v Inland Revenue Commissioner* [1973] 1 WLR 905; *Harding v Coburn* [1976] 2 NZLR 577; *Re Tasman Pacific Airlines of NZ Ltd (in rec & liq)*

[2002] 1 NZLR 688; JF Burrows and RI Carter, *Statute Law in New Zealand* (4th edition, LexisNexis, Wellington, 2009) at p 440. In addition, the courts will generally favour an interpretation of the phrase "subject to" that is consistent with the scheme and purpose of the Act: *Walker v Walker* [1983] NZLR 560.

Section CD 43(15)

9. Section CD 43(15)(a)(i) to (iii) provides:

> *Subscriptions amount: amalgamated company*
>
> (15) The subscriptions amount for a company that is an amalgamated company resulting from an amalgamation—
>
> (a) includes an amount, as if it were consideration received at the time of the amalgamation for the issue of the amalgamated company's shares, equal to the available subscribed capital, at the time of the amalgamation, of all shares in the amalgamating companies that are—
>
> (i) of an equivalent class to the class; and
>
> (ii) not held directly or indirectly by an amalgamating company; and
>
> (iii) not shares in the amalgamated company:

10. Section CD 43(15) applies to a company that is an amalgamated company. All companies involved in an amalgamation are amalgamating companies. A company that exists before an amalgamation and continues as the amalgamated company is both an "amalgamated company" and an "amalgamating company".

11. Section CD 43(15) includes an amount (as if it were consideration received at the time of the amalgamation for the issue of the amalgamated company's shares) equal to the ASC of all shares in the amalgamating companies. This amount, however, does not include the ASC on shares in the amalgamated company by virtue of s CD 43(15)(a)(iii). A definition that uses the word "includes" is generally understood to extend the meaning of the term defined beyond that which it would normally cover: *Dilworth v Commissioner of Stamps* [1899] AC 99; *CIR v Albany Warehouse Ltd* (2009) 24 NZTC 23,532, at [37]. In this situation, the term "includes" operates to add an additional amount to the "subscriptions" amount in s CD 43(2)(b) for an amalgamated company.

12. By reading subs (2)(b) and (15) of s CD 43 together, it can be seen that the ASC of an amalgamated company equals the amount calculated under s CD 43(2)(b) plus the ASC of all the amalgamating companies (but not the amalgamated company). The ASC of all the other amalgamating companies is added to the subscriptions amount of the amalgamated company. Because the amalgamated company may also be an amalgamating company until the amalgamation occurs, s CD 43(15)(a)(iii) is necessary to prevent the subscriptions of the amalgamated company from being counted twice.

Conclusion

13. Accordingly, the Commissioner considers the two provisions do not conflict. Section CD 43(15) merely extends the general definition of subscriptions in s CD 43(2)(b). As a result, the ASC of an amalgamated company includes an additional amount that is equal to the ASC of all the amalgamating companies, except the amalgamated company. Therefore, while s CD 43(15)(a)(iii) appears to exclude the ASC on the shares of the amalgamated company, this subparagraph is necessary to prevent double-counting. This is because the consideration received by the amalgamated company for shares will have already been taken into account under the general definition of "subscriptions" in s CD 43(2)(b). This interpretation of the definition of "subscriptions" for an amalgamated company under subs (2)(b) and (15) of s CD 43 is consistent with the wording of the legislation and the scheme and purpose of the ASC rules.

Example

14. A Co Ltd was incorporated in December 2012 and issued 1,000 shares for $1 each. B Co Ltd was incorporated in December 2012 and issued 2,000 shares for $1 each. Neither company have issued any more shares since. A Co Ltd and B Co Ltd amalgamate in March 2013. A Co Ltd remains as the amalgamated company.

15. The ASC of the amalgamated company is calculated using the following formula:

> 1 July 1994 balance + subscriptions – returns – look-through company returns

16. The subscriptions amount is determined under ss CD 43(2)(b) and CD 43(15). Based on the interpretation in this QWBA, the subscriptions amount equals the subscriptions of the amalgamated company under s CD 43(2)(b) plus the subscriptions of the amalgamating companies under s CD 43(15). However, because an amalgamated company can also be an amalgamating company, s CD 43(15)(a)(iii) excludes the subscriptions of the amalgamated company from being counted again under s CD 43(15).

17. The ASC of A Co Ltd would therefore be calculated as follows:

    1 July 1994 balance + (subscriptions of A Co Ltd under s CD 43(2)(b) + subscriptions of the amalgamating companies (not including the amalgamated company, being A Co Ltd) under s CD 43(15)(a)) – returns – look-through company returns.

    0 + (subscriptions of A Co Ltd of 1,000 + subscriptions of B Co Ltd of 2,000) – 0 – 0

    = 3,000 ASC

References

Subject references
amalgamated company; amalgamating company; amalgamation; available subscribed capital; "includes"; income tax; "subject to"
Legislative references
Income Tax Act 2007, s CD 43(1), (2)(b) and (15), s YA 1.
Case references
C & J Clark Ltd v Inland Revenue Commissioner [1973] 1 WLR 905
CIR v Albany Warehouse Ltd (2009) 24 NZTC 23,532
Dilworth v Commissioner of Stamps [1899] AC 99
Harding v Coburn [1976] 2 NZLR 577
Tasman Pacific Airlines of NZ Ltd (in rec & liq), Re [2002] 1 NZLR 688
Walker v Walker [1983] NZLR 560
Other references
JF Burrows and RI Carter, *Statute Law in New Zealand* (4th edition, LexisNexis, Wellington, 2009)

ITEMS OF INTEREST

CHANGE OF NAME FOR THE ADJUDICATION UNIT TO DISPUTES REVIEW UNIT

The Adjudication Unit in the Office of the Chief Tax Counsel is now called the Disputes Review Unit (Wāhanga Arotake Wenewene) from 1 July 2013.

The new name reflects a slightly broader role and some additional oversight and review functions relating to the tax disputes resolution process that are performed internally.

The Unit is still primarily responsible for conducting adjudication reviews independent of the Service Delivery teams involved in tax disputes. It will also continue to provide Adjudication Reports. There is no change to that function, or what you will see—apart from materials such as letterheads referring to the Disputes Review Unit.

Contact details remain the same, and the primary point of contact remains the Senior Technical & Liaison Advisor in the Office of the Chief Tax Counsel.

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.

JUDICIAL REVIEW PROCEEDINGS FOR ASSESSMENT UNDER SECTION 113 OF THE TAX ADMINISTRATION ACT 1994 IS NOT A BYPASS MECHANISM FOR DISPUTE AND CHALLENGE PROCEDURES

Case	Arai Korp Ltd v Commissioner of Inland Revenue
Decision date	3 May 2013
Act(s)	Tax Administration Act 1994, Judicature Amendment Act 1972
Keywords	Reassessment, correctness of default assessments, attempt to bypass disputes and challenge procedures

Summary

Arai Korp Ltd sought to judicially review the Commissioner of Inland Revenue's ("the Commissioner") decision not to invoke section 113 of the Tax Administration Act 1994 ("TAA") in respect of the applicant's income tax assessments for the 2004 and 2005 income years. The original assessments, which were default assessments, were made by the Commissioner in 2006 and were not disputed nor challenged by Arai Korp Ltd ("Arai Korp") at that time. Arai Korp's application for judicial review was only filed in August 2011 against a background of liquidation proceedings brought by the Commissioner against Arai Korp. The Commissioner had already successfully prosecuted Arai Korp for failing to file income tax returns. The Court found that the Commissioner had not considered the merits of Arai Korp's application for reassessment but that was not fatal as the Commissioner's decision was not unreasonable based on the facts and because Arai Korp had been attempting to circumvent the disputes and challenge procedures.

Impact of Decision

This decision applied the Supreme Court's decision in *Tannadyce Investments Limited v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153 *"that disputable decisions (which include assessments) may not be challenged by way of judicial review unless the taxpayer cannot practically invoke the relevant statutory procedure. Cases of that kind are likely to be extremely rare".*

This case confirms that taxpayers who attempt to circumnavigate the statutory disputes and challenge procedures by issuing judicial review proceedings will be unlikely, in most cases, to be successful with their application for review.

Facts

Default assessments were issued by the Commissioner to Arai Korp Limited for the 2004 and 2005 income tax years on 17 November 2006. These default assessments have never been disputed by Arai Korp through the disputes procedure in the TAA.

The default assessments concerned the proceeds of the sale of a subdivision property situated at 618 Maungatautari Road, Karapiro Cambridge ("the property").

The property was originally owned by Mr Murray Athol Osmond (who is the director of Arai Korp and the director of the sole shareholder, Aniwaniwa Trustee Limited).

On 27 March 1997, the property, save for Units J, K, L and F, were sold to Ran Kor Resources Limited. On or about 30 September 1999, this agreement was allegedly assigned by Ran Kor Resources Limited to Arai Korp.

On 30 September 1999, Arai Korp alleged that Mr Osmond agreed to sell units J, K and L to Arai Korp.

On 28 April 2000, Arai Korp allegedly borrowed funds from the National Bank to purchase Lot 1 and Lot 2 and complete the subdivision.

By 17 October 2003, the subdivision was completed and new titles were issued for Units A to L in the subdivision.

In the 2004 and 2005 income years, Arai Korp made various sales of these units. Notwithstanding this, no income tax returns were filed for Arai Korp. The Commissioner successfully prosecuted Arai Korp for failure to file its returns. The income tax returns for the 2004 and 2005 income years were due on 7 July 2004 and 7 July 2005 respectively.

On 13 November 2006, as a result of an investigation, the Commissioner default assessed Arai Korp for the 2004 and 2005 income years. These assessments were based on Arai Korp's Goods and Services Tax returns.

The Commissioner brought collection proceedings and, after being granted summary judgment, she brought liquidation proceedings. After the commencement of the liquidation proceedings, the applicant sent a letter dated 22 May 2011 to Inland Revenue seeking agreement to fresh tax returns being completed by Arai Korp or for consent to an appeal to the Taxation Review Authority out of time.

The Commissioner treated the letter of 22 May 2011 as being, in effect, a request under section 113 of the TAA to make an amended assessment and, having considered the request, declined it.

Arai Korp issued judicial review proceedings asserting that the Commissioner's decision not to invoke section 113 of the TAA breached the rules of natural justice, that it contained mistakes of fact, that the Commissioner failed to take into account relevant considerations, that she took into account irrelevant considerations and that it was manifestly unreasonable.

Decision

The sole question for the Court was whether the Commissioner's refusal to exercise the discretion vested in her by section 113 of the TAA was manifestly unreasonable.

Section 113 is clear in its terms, conferring a wide-ranging discretion on the Commissioner that can be exercised on her own motion or at the request of a taxpayer. The discretion is available in order to ensure that an assessment is correct. In exercising the discretion, the Commissioner must use her best endeavours to protect the integrity of the tax system, which includes protecting the rights of taxpayers to have their liability determined fairly and according to law. There is no duty to reassess and so, whilst the Commissioner can reassess, there is no obligation to do so.

In essence here, the reasons why the Commissioner, by her delegated officer, declined the request by Arai Korp were that:

a) there had been a full investigation and the Commissioner was confident that the default assessments were correct;

b) Arai Korp was trying to reopen the dispute process and accommodating its request would be treating it more favourably than other taxpayers;

c) additional resources would have to be devoted to verifying the income and deductions belatedly sought by Arai Korp;

d) the request was not in regard to consequential or genuine errors;

e) the facts of case did not meet the criteria detailed in the Commissioner's Standard Practice Statement 07/03.

The Court considered each of the reasons relied on by the Commissioner for her decision.

Correctness of Default Assessment

That there are strict statutory criteria for an extension of time in relation to the disputes or challenge procedures does not affect the broad discretion available under section 113 of the TAA. When faced with an application to exercise the discretion, the Commissioner has to consider whether the assessment is correct. If a convoluted argument is raised to show the assessment is incorrect, then it is to be expected that the Commissioner will be considerably more circumspect and will take into account whether or not the dispute or challenge procedures have been followed by the taxpayer.

Here, the Court found the Commissioner should have given consideration to the merits of Arai Korp's arguments and whether they were capable of affecting the correctness of the default assessments. If the Commissioner had concluded that the matters raised by Arai Korp could not affect the default assessments, that would have been the end of the matter. If she had concluded that Arai Korp might have a bona fide argument, then she should have either determined whether the default assessments were correct or, alternatively, considered whether there were other relevant factors which precluded the exercise of the discretion in any event.

However, although the correctness of the default assessments was a relevant factor, it was not a paramount consideration on the facts of this case and the Court was not persuaded that a failure to address the correctness of the assessment was fatal to the decision to not exercise the discretion in section 113 of the TAA.

Dispute process

There are strict timelines within which the dispute process is required to be initiated. These can only be extended in defined circumstances. Here there was no application for an extension of time by Arai Korp and it had not taken any steps required by section 89K of the TAA.

The Court agreed that section 113 of the TAA is not intended to be used by taxpayers, or indeed the Commissioner, as a way of circumventing the statutory disputes procedure. This is put beyond doubt by section 109 of the TAA. Parliament has put in place detailed provisions detailing how tax disputes are to be resolved, there are strict timelines and there must be finality. The provisions are designed to prevent "administrative chaos".

Arguments as to the substance of assessment can only be raised in challenge proceedings and cannot be raised by way of judicial review. The legitimacy of the process and the validity of the outcome may be challenged in judicial review proceedings on established administrative law grounds. This case is not one of the "extremely rare" cases mentioned by the Supreme Court in *Tannadyce Investments Limited v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153 where an assessment may be challenged by judicial review. Except in extremely rare circumstances, judicial review cannot be used as a backdoor method for considering the merits of the assessments. Here, Arai Corp was challenging the correctness of the assessments and was doing no more than trying to bypass the dispute process. To allow Arai Korp to do so would be to undermine the statutory scheme and treat it more favourably than other taxpayers.

The Commissioner was entitled to take these matters into account and cannot be criticised for doing so.

Available Resources

The Commissioner took into account that the earlier investigation would have to be reopened and resources applied to investigate the request. The Court held this was a relevant factor to take into account in the exercise of the discretion in section 113 of the TAA and the Commissioner had not erred by doing so.

Consequential/Genuine Errors

The Court was not persuaded that section 113 of the TAA distinguishes consequential or genuine errors. However, here, this factor was not crucial to the decision to not invoke section 113 of the TAA.

Standard Practice Statement

The Court found it was not inappropriate for the Commissioner to refer to the Standard Practice Statement. She did not "slavishly follow its dictates" but, rather, applied her mind to the facts and exercised the discretion by reference to those facts.

The Court concluded that the Commissioner's decision to decline Arai Korp's request under section 113 of the TAA was not manifestly unreasonable, the section was not meant to be used to bypass the dispute procedure and this was what Arai Corp was attempting to do. The Court dismissed the application for review.

APPLICATION TO DEBAR CROWN LAW FROM ACTING

Case	Accent Management Ltd & Others v Commissioner of Inland Revenue
Decision date	15 May 2013
Act(s)	Income Tax Act 1994, Lawyers and Conveyancers Act 2006
Keywords	Trinity, tax avoidance, removal/debar Crown Law Office

Summary

An unsuccessful appeal by the taxpayers of the High Court judgment dismissing their application to debar Crown Law from acting for the Commissioner in certain proceedings relating to the Trinity tax avoidance scheme.

During the appeal the principal focus became whether the protocol, between the Commissioner of Inland Revenue and the Solicitor-General, allowed sufficient independence and in particular whether Crown Law could meet their obligations under rule 13 of the Client Care Rules. Dismissing the appeal, the Court of Appeal held the issue under rule 13.5.3 is whether the Solicitor General and Crown Law can discharge their duties to the Court and even on the taxpayers' interpretation of the protocol they could clearly comply with their obligations to the Court.

Impact of Decision

This decision considers the protocol between the Commissioner of Inland Revenue and the Solicitor-General. The Court of Appeal held that the protocol allows both parties to act with sufficient independence so that Crown Law can meet their obligation to the Court and the Commissioner does not delegate her assessment power.

Facts

This appeal relates to the Trinity tax avoidance litigation. The Trinity scheme taxpayers had claimed deductions for the 1997 and 1998 tax years under subpart EG of the Income Tax Act 1994 ("ITA"), but the Commissioner disallowed the deductions on the basis of section BG 1 and imposed penalties. The Supreme Court upheld the Commissioner's decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*"). During the course of the hearing in the Supreme Court, some of the taxpayers sought leave to argue, for the first time, that deduction and spreading issues should have been determined under subpart EH of the ITA, rather than subpart EG. The Court declined to hear those arguments.

Some of the investors in the Trinity scheme have continued to litigate various issues and this was an appeal against a decision of Woodhouse J, in the High Court, dismissing the applications made by the taxpayers for orders that the Crown Law Office ("Crown Law") be debarred from acting for the Commissioner in various proceedings to which the taxpayers and the Commissioner are parties (*Commissioner of Inland Revenue v Accent Management Ltd* [2012] NZHC 1430, (2012) 25 NZTC 20-130).

The application to debar Crown Law was primarily based on allegations that Crown Law could not act with the required degree of independence and could not comply with its duties to the Court. This was because Crown Law had allegedly colluded in assessments being made fraudulently or knowingly on the basis of Part EG rather than EH and had wrongly maintained that position in the *Ben Nevis* proceedings.

As well as dismissing the taxpayers' application, Woodhouse J also awarded indemnity costs against them. Both of these rulings were challenged on appeal.

Decision

In oral argument before the Court of Appeal, Dr Muir for the investors reduced considerably the scope of the appeal. The allegation that Crown Law was insufficiently independent of the Commissioner to meet its professional obligations under rule 13.5 of the Client Care Rules became the principal focus of the appeal. For the sake of completeness, the Court also addressed other issues raised in the written submissions.

Was Crown Law sufficiently independent?

The Court considered that their assessment of the merits of the argument required them to consider the terms of a protocol in place between the Solicitor-General and the Commissioner ("the protocol").

The protocol states that the Solicitor-General is "the Crown's principal professional legal adviser", and, as part of this role, the Solicitor-General has responsibility for "determining the Crown's view of what the law is and conducting the Crown's litigation in the Courts". The Commissioner is "an independent officer of the Crown" and in performing his or her functions he or she will at times require legal advice on the meaning of the law.

The Protocol records that Crown Law and Inland Revenue will "respect each other's roles" and "must work together with the aim of ensuring that [both departments] have consistent positions on the interpretation and application of tax laws".

Dr Muir's argument focused on part 5 of the protocol. Dr Muir said that clauses 5.1 and 5.2 of the protocol provided that the Solicitor-General had an absolute discretion over the conduct of litigation involving the Commissioner. He submitted that this meant that Crown Law was not independent from the Commissioner when conducting litigation. In effect Crown Law was both client and advocate.

Dr Palmer for the Commissioner replied that the protocol simply reflected constitutional orthodoxy. He submitted that clause 4.1 sets out that the Commissioner will consult the Solicitor-General on legal issues, but under clause 4.3, the Commissioner retains independence for determining how Inland Revenue will apply the Solicitor-General's advice. He went on to submit that part 5 of the protocol simply reflect that the Solicitor-General is constitutionally responsible for conducting the Crown's litigation.

Dr Muir submitted that by giving the Solicitor-General the final say in the conduct of litigation involving the Commissioner, the Commissioner unlawfully delegated the Commissioner's powers under sections 6 and 6A Tax Administration Act 1994. This meant that the Solicitor-General and Commissioner were too closely entwined for the Solicitor-General to comply with his or her duties to the Court under rule 13 of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 (the Client Care Rules).

The Court held that Dr Muir's argument was flawed in two respects. First, clause 4.3 of the protocol makes it clear that how the Commissioner applies the law is left to the Commissioner; the Commissioner does not delegate her assessment power. Second, the issue under rule 13.5.3 is whether the Solicitor-General and Crown Law can discharge their duties to the Court. Even if Dr Muir's interpretation of the protocol was correct, clauses 5.1 and 5.2 make it clear that the Solicitor-General is free to conduct litigation as he or she chooses. The Solicitor-General is thus free to comply with his or her obligations to the Court.

The Court considered that the protocol set out the boundaries of a consultative working relationship between the Solicitor-General and Commissioner, reflecting their constitutional roles. The Commissioner is an independent officer of the Crown and clause 4.3 of the protocol recognises that the Commissioner retains independence in determining how Inland Revenue will interpret the law. Litigation against the Commissioner is litigation against the Crown and so it is constitutionally proper that the Solicitor-General should have the final say about how litigation involving the Commissioner is conducted as recognised in clauses 5.1 and 5.2 of the protocol.

The Court concluded that the answer to this ground of appeal was that there was nothing in the protocol that raised a risk that Crown lawyers would not be able to discharge their professional obligations in the extant challenges. The Court concluded that there was nothing to suggest that Crown Law would have any "compromising influences or loyalties" (rule 5) that would prevent it from acting.

Was there an estoppel preventing Woodhouse J from considering the application of the Lawyers and Conveyancers Act 2006 and the Client Care Rules to Crown Law?

Woodhouse J did not find that there was an estoppel. The Court of Appeal confirmed that the taxpayers had no reasonably arguable factual foundation for their allegations against Crown Law.

Was Woodhouse J correct to award indemnity costs against the taxpayers?

The Court reiterated that the award of indemnity costs is the exercise of a judicial discretion, as set out in rule 14.6(4)(a) of the High Court Rules, and held that the taxpayers did not demonstrate that Woodhouse J erred by acting contrary to principle, disregarding a material factor or being wholly wrong.

The Court considered this appeal proceeding also a further step in the "gaming" referred to by Woodhouse J in the High Court and considered that the present proceeding is one in a long line of attempts to re-litigate the *Ben Nevis* proceedings, and another attempt to make allegations of fraud and concealment against the Commissioner and Crown Law that have already been dealt with.

The appeal was dismissed and indemnity costs awarded to the Commissioner.

NO SPECIAL CIRCUMSTANCES JUSTIFYING APPEARANCE BY TAX AGENT AND DISTRICT COURT DEBT RECOVERY PROCEEDING IS NOT APPROPRIATE FORUM TO DISPUTE ASSESSMENT

Case	Huston v Commissioner of Inland Revenue
Decision date	2 May 2013
Act(s)	District Courts Act 1947, Tax Administration Act 1994
Keywords	Appearance by a tax agent, section 109 of the Tax Administration Act 1994

Summary

There were no special circumstances justifying the appearance by the appellant's tax agent on the appellant's behalf in the District Court. The effect of section 109 and *Tannadyce Investments Limited v The Commissioner of Inland Revenue* is that the District Court debt recovery proceeding is not the appropriate forum for assessment matters to be raised.

Impact of Decision

This case is a further endorsement of the principles in the decision of *Tannadyce Investments Limited v The Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153, namely that under section 109(a) of the Tax Administration Act 1994, no disputable decision may be disputed in a court or in any proceedings on any ground whatsoever except in objection proceedings under Part VIII or a challenge under Part VIIIA of the Act.

Facts

This is an appeal against a judgment of the District Court on a claim by the Commissioner of Inland Revenue ("the Commissioner") against the appellant for arrears of tax including some penalties and interest (*Inland Revenue Department v Huston* DC Manukau CIV-2011-092-000596, 31 October 2012).

While Mrs Huston ("the appellant") did not appear in the District Court, the appellant's tax agent, Mr J G Russell, attended the District Court on her behalf. However, the Court recorded that Mr Russell had no right of audience before the Court.

The central issue sought to be raised on behalf of the appellant in the District Court was that there had been failure by the Commissioner to transfer funds from another taxpayer's account which, it was contended, would have been sufficient to clear the base tax liability.

The Court held that the matter was essentially a tax recovery case where the assessments were not in fact disputed at all and found that the appellant's notice of proposed adjustment ("NOPA") did not relate to a disputable decision. The Court considered that while the appellant may have requested that the tax debt be paid by the appellant's family trust, that in itself did not relieve her of her statutory obligation to pay tax debts when they become due. Accordingly, the District Court entered judgment against the appellant.

Decision

The issues were considered separately by the High Court.

Whether the District Court erred in finding that Mr Russell was not entitled to appear on behalf of the appellant

Section 57 of the District Courts Act 1947 provides that except "under special circumstances" a party can only appear in person or through a barrister or solicitor.

The appellant advanced the argument that Mr Russell's detailed knowledge of her tax affairs and his expertise in the field constituted special circumstances for the purposes of section 57.

The Court found that these were not special circumstances and that if they were, it would justify granting leave to appear on behalf of a party in any case where the party engaged a specialised agent. Woodhouse J also considered that it would not have been possible on any proper basis for Mr Russell to not only appear effectively as the appellant's advocate, but also to give evidence on the appellant's behalf (which had been proposed). Further, the Court stated that the District Court's decision involved the exercise of a discretion and that there was no basis on appeal for interfering with the exercise of that discretion in this case.

Given the Court's decision on the right of audience issue, the High Court accordingly held that there was also no basis upon which evidence could have been called by Mr Russell or upon which Mr Russell could have cross-examined the Commissioner's witness.

Whether the District Court erred in finding that there was no disputable decision

The Court noted that there was unchallenged evidence in the affidavit of the Inland Revenue officer in respect of the assessed tax liability and that there was no challenge to the core assessments for the three years in question. This was expressly acknowledged by the appellant through Mr Russell. The Court considered that the dispute regarding the transfer of money from another taxpayer's account to pay the core tax of the appellant did not bear on the assessment (whether the argument was correct or not). In any event the Court found that it could not be a matter of enquiry in the District Court due to the effect of section 109 of the Tax Administration Act 1994 ("TAA").

Was the assessment proposed in the NOPA deemed to be correct?

The appellant argued that as a consequence of a NOPA issued by Mr Russell for the appellant, there was no tax liability. In broad terms, this was because the NOPA proposed credit transfers from a family trust to eliminate the liability. The appellant submitted that as the NOPA was not challenged by the Commissioner in accordance with the statutory procedures under the TAA, the assessment proposed in the NOPA was deemed to be correct.

The High Court was satisfied that the District Court came to the correct conclusion on this point as fundamentally, the contentions on behalf of the appellant could not be a matter of enquiry in the District Court, noting that this was the effect of both section 109 of the TAA and the decision of the Supreme Court in *Tannadyce Investments Ltd v The Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.

In any event, the Court noted that there was a response by the Commissioner to the NOPA by way of letter dated 13 July 2007 advising that a credit in the account of M & J Huston Family Trust had already been used to pay GST arrears (and therefore no funds were available for the transfer).

The High Court also recognised that the current proceeding was issued around four years after the NOPA was issued and therefore could not on any reasonable basis be construed as the equivalent of a statutory response. The Court considered that the Commissioner's claim made it clear that the Commissioner was proceeding on an entirely different basis from that proposed in the NOPA and therefore, the proper response on behalf of the appellant would have been either to seek leave to invoke the challenge proceedings in the TAA out of time for special reasons, or to seek judicial review of the Commissioner's decision to proceed with the claim for tax arrears which the appellant contended were not owing.

The High Court concluded that it is clear that the District Court proceeding for recovery of claimed tax arrears could not be the forum for raising the matters sought by Mr Russell. Accordingly, the Court considered it unnecessary to consider further submissions for the Commissioner as to whether the NOPA gave rise to a disputable decision and that in any event, for reasons already noted, such consideration would appear not to be a matter for enquiry in the current proceeding, whether in the District Court or in the High Court as the Court on appeal. The Court was therefore satisfied that the District Court had made the correct decision and the appeal was dismissed.

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