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TAX INFORMATION Bulletin

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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED00160	Draft general depreciation determination – Frost Fan (mobile)	This draft determination proposes to set a general depreciation rate for Frost Fans (mobile).	31 October 2013

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Legal decisions – case notes

Court of Appeal confirms High Court decision 72

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The Supreme Court declined leave to appeal from the Court of Appeal upholding a child support departure order.

NEW LEGISLATION

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

ORDER IN COUNCIL

FOREIGN INVESTMENT FUND DEEMED RATE OF RETURN SET FOR 2012–13

The deemed rate of return for taxing certain foreign shares is 6.91% for the 2012–13 income year, down from the previous year's rate of 7.58%.

The deemed rate of return is set annually and is used to calculate income from certain foreign shares with debt-like properties and for which a year-end market value is not available (such as a fixed-rate share in an unlisted foreign company).

The rate is based on taking an average of the five-year Government bond rate at the end of each quarter, to which a 4% margin is added.

The new rate was set by Order in Council on 26 August 2013.

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2012–13 Income Year) Order 2013 (2013/338)

TAXATION (LIVESTOCK VALUATION, ASSETS EXPENDITURE, AND REMEDIAL MATTERS) ACT 2013

The Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill was introduced into Parliament on 13 September 2012. It received its first reading on 29 November, the second reading on 27 June 2013 and its third reading on 10 July 2013. The resulting Act received Royal assent on 17 July 2013.

The new Act introduces a range of measures to help improve the integrity of the tax system. These include:

- tightening the deduction rules for assets used for both private and income-earning purposes;
- changes to the GST rules, including a registration system to allow GST refunds for certain non-resident businesses;
- making lease inducement and lease surrender payments taxable to the recipient and tax deductible for the payer; and
- further detail to support the livestock valuation rules that were amended as part of Budget 2012.

The new Act amends the Income Tax Act 2007, Income Tax Act 2004, Tax Administration Act 1994, Goods and Services Tax Act 1985, KiwiSaver Act 2006, Student Loan Scheme Act 2011, Stamp and Cheque Duties Act 1971, Social Security Act 1964, the Search and Surveillance Act 2012, Child Support Amendment Act 2013, and various regulations.

NEW LEGISLATION

LIVESTOCK AMENDMENTS

Sections EC 4B, EC 4C, EC 7, EC 8, EC 11, EC 20, EC 21, FB 15, YB 1 and Schedule 17 of the Income Tax Act 2007

These amendments follow on from the 2012 Budget legislation that made herd scheme elections irrevocable. The original proposals were announced on 28 March 2012, but were then subject to further consultation and refinement. The changes in the new legislation reflect the results of this further consultation.

Background

It became apparent that some farmers were taking inappropriate advantage of the ability to exit the herd scheme with a short period of notice to achieve tax-free increases in livestock values under the herd scheme, and tax deductible decreases in values under a cost-based regime. Along with this, a few farmers were doing associated parties transactions to achieve the same result.

Officials released an issues paper on the problem and potential reforms on 18 August 2011. While there was debate on alternative solutions, there was complete acceptance of the problem, both at a high level and in detail. This led to the Government's 28 March 2012 announcement that, from 18 August 2011, elections to exit the herd scheme could not be made.

These technical amendments in the new legislation follow on from the Budget 2012 amendments that made an election to use the herd scheme irrevocable. While the new legislation generally follows the pattern of the 28 March 2012 announcement, a number of enhancements have been made.

Key features

The amendments deal with specified livestock only (sheep, beef and dairy cattle, deer, pigs and goats). They deal with:

- associated persons transactions where and to the extent that the vendor is using the herd scheme—essentially the purchaser assumes the vendor's herd scheme elections, base numbers and values;
- exceptions from associated persons rules for inter-generational transfers—the effect being that the qualifying purchaser is free to make their own valuation elections;
- refinements to the rules for ceasing farming other than by way of an associated persons transaction when the vendor is using the herd scheme;
- an exception to the irrevocable herd scheme election rule when the farming operation changes to a fattening operation;
- there is some rationalisation of specified livestock classes; and
- a number of supporting detailed amendments.

Detailed analysis

In summary the amendments are:

- Section EC 4B makes the use of the herd scheme compulsory for associated party transfers of livestock the vendor would otherwise have valued in the herd scheme, and provides an exception for inter-generational sales.
- Section EC 4C provides the values at which these herd scheme livestock are to be worth transferred at.
- Section EC 7 is a clarifying amendment.
- Section EC 8, which deals with restrictions arising from the use of the herd scheme, has been replaced in two tranches. The first tranche, which applies from 18 August 2011, introduces an exception to the herd scheme election being irrevocable if the farming operation changes to a fattening operation. The second tranche, which applies from 28 March 2012, adds mechanical issues to do with base herd scheme numbers.
- Section EC 11, which deals with restrictions on making elections, has been consequentially amended.
- Section EC 20, which deals with valuations upon ceasing farming has been amended to introduce a before or after 1 November date for the compulsory use of opening or closing herd scheme values.
- Section EC 21, which used to deal with herd scheme valuation elections on a farmer's death, is repealed as its purpose has been subsumed by the associated persons transaction rules.
- Section FB 15, which deals with matrimonial property transfers, has been amended to make it clear that one party steps into the other party's position when a matrimonial property settlement involved livestock valued under the herd scheme.
- Schedule 17 is amended to rationalise certain classes of livestock.

Associated party transfers of herd scheme livestock

Sections EC 4B, EC 4C, EC 8, EC 11 and FB 15

Some farmers used associated party transactions in an attempt to exit the herd scheme without giving the required advance notice. Inland Revenue questioned some of these transactions and it became clear that a legislative response to associated persons was required when the vendor used the herd scheme.

However, as a result of submissions it became apparent that this could inappropriately impose tax on inter-generational transfers of herd scheme livestock, and it was agreed to exempt these in appropriate circumstances—these circumstances are limited.

The amendments apply from 28 March 2012.

The core rule

The new rules provide that for associated persons transfers of herd scheme livestock the acquirer steps into the position of the vendor for the herd scheme election, herd scheme base numbers and herd scheme values.

The general definition of "associated person" applies.

The associated persons rules only apply where the transfer is not in the ordinary course of business. Thus a father and son situation where the son runs the back country breeding farm and the father runs a front country fattening farm will generally not come under rule if the father buys stock from the son to fatten. However, if the father doubles the size of his farm and buys some breeding stock (other than stock that the son would have ordinarily been culled) from the son, then that stock will be subject to the new rules. Given the various potential scenarios this has been deliberately left up to the parties' judgement. Common sense should apply.

In qualifying circumstances, the transferee will be treated as having made a herd scheme election (section EC 4B(4)). This overrides the more general herd scheme election rules.

These circumstances are where the vendor would otherwise have valued those livestock in the herd scheme at the end of his or her income year. This is controlled by the formula in section EC 4B(5). The steps involved are as follows:

Step 1: The vendor calculates hypothetical year-end numbers for a class as if the associated persons sale had not taken place.

Step 2: These are then compared with the vendor's opening herd scheme tallies for that class.

Step 3: The lowest of these numbers (being the minimum that the vendor could value in the herd scheme in the year of transfer if the transfer had not occurred) becomes the "hypothetical year-end herd scheme amount".

Step 4: From this is subtracted the actual year-end numbers of the class that the vendor has on hand.

Step 5: The balance is then the number of livestock of that class that the associated person acquirer must value in the herd scheme.

Note that the calculations focus on the class that the livestock would be (or would have been) at year-end, not as at the date of the transfer.

Example

Step	R2 Heifers	Example A	Example B
1.	On hand at year-end	80	80
1.	Associated party transfer	25	15
1.	Hypothetical year-end numbers	105	95
2.	Opening herd scheme	100	100
3.	Lesser of	100	95
4.	Actual on hand	80	80
5.	Therefore acquirer herd scheme	20	15

Subsections EC 8(3)–(4) as they apply from 28 March 2012 provide that the acquirer's minimum herd scheme numbers for that class and that year are increased by the number obtained from the section EC 4B(5) formula that is illustrated immediately above.

Matrimonial property settlements

Section FB 15 has been consequentially amended as the associated persons herd scheme rules should apply to these settlements.

Associated party transfer values for income tax purposes

Section EC 4C provides that for income tax purposes the transfer of livestock that the acquirer is required to value in the herd scheme is deemed to take place at herd scheme values that apply at the end of the year of the transfer, presuming that both parties are in the same tax year when the transfer takes place. If this is not the case, it depends on which of the parties is in a later tax year, but the objective is to ensure that there is one herd scheme adjustment to opening herd scheme livestock valuations for each tax year.

If the acquirer is in an earlier tax year than the transferor's, the values are the vendor's opening herd scheme values for the vendor's year of transfer. That is, the acquirer acquires the transferred herd scheme livestock at the herd value that applies at the end of the acquirer's tax year.

If the acquirer is in a later tax year than the vendor, the values are the vendor's closing herd scheme values for the vendor's year of transfer. For the purposes of the herd scheme adjustment in the year the acquirer received the herd scheme livestock, only the acquirer is deemed to own them at the end of their previous year.

For GST purposes, the sale is taxed at the values it actually occurs at. Where the vendor is a company, any difference between sale values and deemed tax values is regarded as an increase or decrease to retained earnings and under current law is taxable upon distribution.

For tax purposes any other livestock transfer at the usual market values.

Intra-generational exception to the associated persons rule

Where there is a clear transfer of herd scheme livestock down the generations (parents or grandparents to children or grandchildren) then in qualifying circumstances the associated persons rule does not apply.

In brief:

- the lower generation should have had no interest in the livestock before the transfer;
- the higher generation should cease deriving income from the disposal of specified livestock; and
- the transaction should be at market values and, except for financing, market terms.

Associated persons

To make this work there is a complicated application of the associated persons rules. Essentially, where the only connection up the generations is the blood relationship between the generations then the exception can apply. Thus if the lower generation are not associated with a trust, or a company or a partnership or a sole trader which is the livestock owning entity, other than by the blood relationship, the exception can apply.

Examples of non-association include where the lower generation are not:

- beneficiaries of the higher generations' trust that owns and farms the livestock;
- associated with the higher generations' company that owns and farms the livestock except through the blood relationship; and
- associated with the higher generations' blood relations (and their entities) where there is no other association and the blood relations (and their entities) carry on a separate farming business.

Ceasing deriving income from livestock

The higher generation should cease deriving income directly or indirectly from the disposal of specified livestock that is part of a business for the next four years. Thus the vendor can graze a few animals on a lifestyle block (for the freezer or whatever), or can retain the land and enter into a 50/50 sharemilking arrangement with the next generation, or can start farming non-specified livestock, all without disturbing the exception.

The "indirectly" reference is to the situation when the livestock are owned by a trust or company that the vendor is associated with. The four-year period was chosen because it should be long enough to confirm there was a genuine intention to cease deriving income from livestock.

Deceased farmers and their estates

Section EC 4B(3) provides that the associated persons exception will apply to a deceased estate if:

- the more general associated persons exception would have applied had the deceased (or a person associated with the deceased) transferred the herd scheme livestock to the next generation, who are capital beneficiaries of the will, immediately before his or her death; and
- the estate does not have a life tenant.

Section EC 21, which governed herd scheme values where the farmer died, has been repealed as the associated party rules, and the exception thereto, will, as appropriate, apply.

Change of use exception to the irrevocability of herd scheme election rule

When the farming operation changes from a breeding operation to a fattening operation, a one-off election to leave the herd scheme is available. This recognises that a cost-based regime is likely to be more appropriate for a fattening operation.

Specifically, for a type of specified livestock where the farmer's intention is that they cease to be used for a breeding business, and instead are used in a fattening business, a written election to exit the herd scheme for that type of livestock may be given.

This election applies from 18 August 2011, the date that the revocation of the more general election to exit the herd scheme applies from.

Cessation of farming by third party sale

Section EC 20, which used to provide that farmers who were using the herd scheme could elect, in qualifying circumstances, whether to make an opening herd scheme valuation adjustment, has been amended to make it compulsory not to adjust opening herd scheme values. The amendment means:

- it applies when the farmer ceases deriving income from the disposal of specified livestock (that is, they could still own land subject to a 50/50 sharemilking agreement);
- the sale is not an associated persons sale, except where the inter-generation exception applies;
- it is compulsory when the cessation occurs before 1 November; and
- the notice requirement has been repealed.

This applies from the start of the 2012–13 income year.

Rationalisation of some classes of livestock

There has been some concern expressed about the uncertainties of whether dairy cattle are Friesian or Jersey, and whether some deer are Red or Wapiti. The 17th Schedule has been amended to combine these breeds. This is effective from the 2014–15 year. It is acknowledged that this will result in some averaging of herd scheme values (eg, Friesian values will decrease a bit and Jersey values will increase).

As an interim measure, for the 2012–13 and 2013–14 years, these breeds are regarded by section EC 8 as being combined. This section, among other things, deals with minimum livestock numbers in the herd scheme. Where dairy cattle or deer change from one breed to the other (for example Friesian to Jersey), the minimum numbers for each class are added together.

MIXED-USE ASSETS

Sections CC 1, CW 8B, CX 17, DB 5, DB 7, DB 8, subpart DG, DZ 21 and YA 1 of the Income Tax Act 2007 and section 30D of the Tax Administration Act 1994

These amendments establish a new basis for apportioning deductible expenditure relating to certain assets which are used both privately and to earn income (mixed-use assets). The changes, which follow the original Budget 2011 announcement and subsequent consultation, are aimed at making the tax rules fairer.

Background

For most assets, it is straightforward to determine whether expenditure is deductible. If the asset is only used to derive income or used in business, related expenditure will be deductible.[1] If the asset is only used privately (such as a private house or a car) then no deduction is available for related expenditure.[2] Because mixed-use assets combine both private and income earning use in a single asset, difficult questions arise about the appropriate portion of expenditure that will be deductible.

The easiest way to explain this is to divide expenditure into "daily amounts". If a bach is used by its owners for 40 days in a year, and rented out for 25 days in that year, it is clear that:

- 40 days' worth of expenditure is not deductible
- 25 days' worth of expenditure is deductible.

What is not clear is what happens to the expenditure which relates to the 300 days of the year when the asset is not used at all.

Under the previous rules, the 300 days when the asset is "available for income-earning use", also gave rise to deductions. This means the owner would claim deductions for expenditure relating to 325 days, or 89% (325/365) of total expenditure.

This was not considered an equitable outcome, given that the asset was used both for income earning and private purposes, and indeed, the principal purpose of acquisition may well have been private.

Key features

These amendments apply to real property used for short-term accommodation and to boats and aircraft that cost more than $50,000—collectively called mixed-use assets. They establish an apportionment method to determine the deductibility of expenditure associated with them.

The proportion of expenditure that is now deductible is calculated by dividing the number of days in which the asset was actually used to earn income by the total number of days the asset was actually used (for both income-earning and private purposes). In the example above, this would mean the owner would now be able to claim 38.5% of expenditure (25 days of income earning ÷ 65 days of total use). This is the key rule in these amendments.

A number of other changes have also been made to support the apportionment method:

- rules to allow asset owners to treat the asset as outside the tax system (no tax on income but no deductions allowed). Owners can opt out of the tax system if the asset has earned gross income of less than $4,000, or where ring-fenced losses (as described below) are generated;
- rules which apply where income-earning use of these assets is low (2% or less of asset value) and tax losses are generated. These tax losses cannot be offset against other income, but must be carried forward to future income years. This deals with the difficulty of knowing whether a loss arising from a mixed-use asset is a genuine loss (that should be allowed) or a loss which arises because the apportionment formula has failed to exclude all of the private benefit (which should be denied). This is described as "deduction quarantining", but is conceptually the same as loss ring-fencing;
- rules to deal with interest expenditure for mixed-use assets that are held in company structures. These rules ensure that fair treatment is delivered to assets in these structures compared with individual ownership, so they do not create a situation where people can avoid apportionment of interest expenditure by moving the asset into a company structure.

The rules apply to mixed-use assets owned by all forms of entities except companies that are not close companies.

Application dates

The new rules apply to mixed-use assets which are land (including improvements) from the beginning of the 2013–14 income year. Mixed-use assets which are boats and aircraft are subject to the rules from the 2014–15 income year.

[1] Section DA 1, general permission, Income Tax Act 2007.

[2] Section DA 2, general limitation, Income Tax Act 2007.

Detailed analysis

The key amendment is new subpart DG. It is structured as follows:

- Section DG 1 – High-level description of what subpart DG does;
- Section DG 2 – Sets up the relations with the rest of the Income Tax Act, and establishes some general principles about the application of the rules - the rules apply on an asset by asset basis, the treatment of group companies and how voting and market value interests are ascertained;
- Section DG 3 – Details which assets are subject to the rules;
- Section DG 4 – Describes what is private use;
- Section DG 5 – Defines interest expenditure for the purposes of the subpart and points to later sections that apportion it;
- Section DG 6 – Extends the associated persons rule to make a person and company associated if the shareholding gives them a right to use the asset;
- Section DG 7 – Allows certain income-earning expenditure to be fully deductible;
- Sections DG 8 and DG 9 – Set out the key apportionment rule;
- Sections DG 10 to DG 14 – Set out the interest apportionment rules when the mixed-use asset is owned by a company;
- Sections DG 15 to DG 19 – Detail the quarantining or loss ring-fencing rules;
- Section DG 20 – Sets out the treatment when the mixed-use asset's income cannot be directly ascertained;
- Section DG 21 – Sets out when an owner can treat the asset as outside the tax system (no tax on income, but no deductions allowed); and
- Section DG 22 – Deals with assets held for part of the year.

Other new sections or amendments are:

- New section CW 8B to provide that certain income from mixed-use assets that would otherwise be gross income is exempt income (and section CC 1 is consequentially modified);
- Section CX 17, which deals with fringe benefits provided to shareholders, is amended;
- The interest deductibility rules in sections DB 5, DB 7 and DB 8 are amended and subpart DG overrides them as appropriate;
- Section DZ 21 is added to allow for the depreciation roll-over when a mixed-use asset that was owned by a company is transferred to the shareholders; and
- The definitions in section YA 1 are amended.
- Section 30D regarding notice requirements is added to the Tax Administration Act 1994.

Assets subject to the rules

Section DG 3

Section DG 3 sets out which assets will be subject to the mixed-use asset rules in an income year. There are three key criteria:

- Use of the asset;
- Type of asset;
- Ownership of asset.

Use

Section DG 3(1) defines "asset" (referred to as a mixed-use asset). The key criterion for a mixed-use asset is that the asset must be used to earn income and also used privately. The important concept of private use is discussed in the next section. Additionally, the asset is required to be unused for at least 62 days in the income year or, where the asset is typically only used on working days, unused for 62 working days in the income year.

Type of asset

The new rules only apply to assets which are:

- Land (including improvements to land). The rules will typically apply to holiday homes, but city apartments and such like may also fall inside the rules. In particular, the rule applies to the provision of short-term accommodation (long term-accommodation is specifically excluded);
- Ships, boats and other water craft;
- Aircraft.

There are two important points to note about these last two categories of mixed-use asset.

The mixed-use asset rules only apply to boats and aircraft which have a cost to the person of $50,000 or more, or if they were not acquired at market value, their market value on acquisition was $50,000 or more. The market value rule covers situations where assets are acquired from related parties at less than market value. Where the asset is acquired by a partnership or a look-through company (LTC) it is the cost to the partnership or LTC that is relevant, not to the partners or shareholders.

The concepts of "ships, boats or craft" and "aircraft" are not defined. They are intended to have a broad ordinary meaning.

In the case of all three categories of assets, for the purposes of these rules, the asset will include any assets which are related to it. So, in the context of a holiday home, items such as the furniture and appliances will be subject to the rules, and in the context of a yacht, items such as the dinghy and the lifejackets will be included.

Entities subject to the rules

The rules apply to any person claiming deductions in relation to the asset, not just the person who owns it. For example, a person who leases an aircraft, and then uses it personally and rents it out, will be subject to the rules.

The rules apply only to close companies (ie, they do not apply to assets held by a company unless that company meets the definition of a close company).

Exclusions

Some assets which meet the above criteria are still excluded from the rules. An asset is excluded in the following circumstances.

- The private use is minor and the asset is primarily used in a business which is not a rental or charter business. If the asset is owned by a company, private use creates an obligation to pay FBT or income tax. This excludes circumstances such as a helicopter which is generally used on a farm but is used for say 3% of its operating time for private purposes. "Minor" is undefined for these purposes and bears its ordinary meaning.
- It is a residential property which has long-term rental as its only income-earning use. This deals with situations such as when a person's home which is occupied by them for the first part of the year, remains empty for a period of three months while they work in another part of the country, and then rented out by them as an ordinary residential rental when they decide to remain in that other part of the country long-term.
- A similar rule also applies for boats and aircraft which are initially used by the owner and then undergo a change of use, and are rented out after that change of use (the rule also applies to assets which are initially rented out and then used exclusively by the owner following the change of use). An example would be a boat which is used as a private asset for the first part of the year, and then rented out during the second part of the year following the owner's acquisition of a new boat for private use.

Concept of private use

Section DG 4

The concept of private use is important to establish whether an asset is a mixed-use asset, because one of the criteria for an asset to be a mixed-use asset is that it is used both to earn income and privately.

There are three categories of private use.

The first is use of the asset by a natural person (an individual) who is the person who owns, leases, licenses, or otherwise has the asset. This will cover the simplest situation where the asset is owned by a natural person, and that person uses their own asset.

The second is the use of the asset by a natural person who is associated with the person who owns, leases, licenses or otherwise has the asset. Two common situations which this rule will cover are:

- The asset is owned by a natural person, and is used by that person's close relative (see section YB 4).
- The asset is owned by a company (or trust or partnership), and used by a natural person who is associated with that company, a trust or partnership (see section YB 3).

Use by a person who falls into one of the above categories will constitute private use even if the person uses the asset along with others—such as when the owner stays in the bach along with some of her friends, even if the friends pay market rental.

Use by a person who falls into one of the above categories will also constitute private use regardless of any amount paid for the use. However, any amount which is paid will be treated as exempt income (see sections DG 4(6) and CW 8B) which means that it will not be taxable. The use will not be considered income-earning use for the purposes of the apportionment formula, which means that it does not increase the level of deductibility.

The third category is where the asset is used by a person who is not associated with the owner, but who pays less than 80% of the market value of that use. Market value is specifically defined in section DG 3(5) for these purposes using the concepts of open market, ordinary terms and arm's length. It is intended to capture situations such as when an asset is made available to a friend or a person otherwise connected with the owner for a price which is clearly lower than that ordinarily charged to renters with no connection with the owner. It is not intended to capture situations when an asset is rented by an unrelated person at a lower price for reasons such as:

- the asset is being rented in an "off-peak" or "quiet" period;
- the asset is being rented for a longer period than it is usually rented for; and
- the asset is being rented at a reduced price to establish profile or a market share.

If the rate the asset is rented for would have been offered to any other person who wanted it for that period or during that time, that will be a market rate.

As with payment for the use of an asset by an associate, any amount received which is less than 80% of market value is not required to be returned as income for tax purposes, and use for which less than 80% of market value is paid does not constitute income-earning use for the purposes of the apportionment formula.

Private use exemptions

There are three exemptions which exclude certain use from the definition of "private use"

The first covers situations when the owner uses the asset to earn income in the ordinary course of their business. For example, a person who owns a boat will not be treated as using the boat privately when he or she takes out skippered fishing charters, if that is in the ordinary course of the business.

The second exemption covers situations when the owner uses the asset to carry out repairs caused by someone who rented the asset. For example, a bach might be rented to people who damage it. The owner might then need to stay in the bach to repair that damage because the owner lives some way away, and it will take more than one day to repair the damage. The use by the owner to repair the bach will not constitute private use.

The third exemption covers situations when the owner uses the asset to relocate it at the beginning or end of a period of hire, the relocation is necessary to enable the hire, and the income derived by the owner directly or indirectly includes an amount for the relocation.

Example

Mary owns a launch. During the course of an income year, she takes her family out on the launch, she lets her brother use the launch (paying the market rate of $200 per day) and she lets her friend use the launch (paying fuel costs only at the rate of $50 per day).

All these uses are instances of private use. The $200 per day which Mary receives from her brother and the $50 per day that Mary receives from her friend are exempt income so not subject to tax.

When Mary rents out the launch to non-associates at market rates, takes the launch to another port for rental to non-associates at $250 per day and then back again to the home port, or takes the launch to a boatyard for repair after damage was caused by a non-associate during a rental period, none of these instances is private use.

Expenditure which is deductible in full

Section DG 7

The primary objective of the new rules is to set in place an apportionment mechanism so that the deductibility of expenditure is determined by the ratio of income-earning use to total use. However, the new rules recognise that there are some items of expenditure that ought to be deductible in full, even though the underlying asset has some private use. The new rules allow expenditure to be deducted in full where:

- it relates solely to the use of the asset for deriving income, and either is expenditure from which the person who owns or otherwise has the asset would not reasonably expect to receive a personal benefit (or, when a company owns or otherwise has the asset, no associate of the company would receive a personal benefit); or
- the expenditure must be incurred to meet a regulatory requirement to use the asset to earn income.

The simplest example would be advertising expenditure—it solely relates to the income-earning use of the asset, and delivers no personal benefit to anyone.

An exception to this rule is expenditure on repairs and maintenance. The rules provide that repairs and maintenance cannot generally be treated as falling within this provision, which means that they will always be subject to apportionment. There is one carve-out from this exception. Where costs are incurred to repair explicit damage caused when an asset is used to earn income, that repair cost will be deductible in full.

For example, a bach is rented out and the renters leave the barbecue on overnight, causing heat damage to a nearby wall. The costs of repairing that damage will be deductible in full.

Example

John operates a charter boat which he also uses privately. He incurs expenses, including costs in meeting Maritime New Zealand survey requirements, advertising costs, and general maintenance costs. The advertising costs are fully deductible because they deliver no personal benefit. The survey costs are fully deductible if they are incurred only for charter purposes. The general maintenance costs are not deductible under this provision because they deliver a personal benefit as well as an income-earning benefit. A portion of these maintenance costs may be allowed as a deduction under the apportionment rules.

Expenditure subject to apportionment

Sections DG 8 and DG 9

The apportionment rules are the core of the new rules for mixed-use assets.

The apportionment rule is used to determine the deductibility of expenditure (and depreciation loss) which relates to the asset and is not expenditure which is fully deductible under the provision referred to above, or expenditure which relates purely to the private use of the asset. This expenditure will typically include rates, insurance, general repairs and maintenance.

The expenditure will include interest expenditure incurred by owners on debt which relates to the mixed-use asset (debt that has been identified through a tracing rule). However, special rules apply to interest incurred by companies other than qualifying companies as, in the absence of these rules, the interest would generally be fully deductible.

The proportion of the expenditure which will be deductible is calculated by using the following formula:

$$\text{Expenditure} \times \frac{\text{income-earning days}}{\text{income-earning days} + \text{counted days}}$$

Income-earning days are those days when the asset is used to earn income, other than exempt income (such as when the asset is rented to associates or for less than 80% of the market value). This includes days when the asset is used in a wider business and therefore the income is derived indirectly.

Income-earning days also include days when the asset is used by the owner to repair damage caused by a renter, where the asset is relocated to facilitate a rental and the cost of that relocation is included in the rental, and where the asset is unavailable for use because it had been reserved by someone but they did not use it. Days for which the use of the asset triggers a fringe benefit tax liability also count as income-earning days.

Counted days are those days when the asset is in use, but the use is not an income-earning day. Counted days will therefore include days when the asset is used privately, and when the asset is used to earn exempt income—by being rented to associates or for less than market value.

Units other than days can be used if they achieve a more appropriate apportionment. For example, nights would probably be a better unit of measurement for accommodation, and flying hours for aircraft.

Depreciation itself is usually apportioned by the mixed-use assets rules, but gain or loss on sale is dealt with by the relevant rules in subpart EE. Further, when depreciation is apportioned on the basis of floor area or similar, that basis is not overridden by the mixed-use assets apportionment rules.

Example

Jim rents out his aeroplane at market value for 100 hours in an income year, and uses it for his personal enjoyment for 50 hours. Jim incurs expenditure of $10,000 for general repairs and maintenance of the plane. He may deduct two-thirds of the expenditure. His deduction is calculated as follows:

$\$10,000 \times (100 \div (100 + 50)) = \$6,666.67$

Example

Mary owns a launch. During the course of an income year, she takes her family out on the launch for 20 days, she lets her brother use the launch (paying the market rate of $200 per day) for 5 days and she lets her friend use the launch (paying fuel costs only at the rate of $50 per day) for 1 day.

Mary rents out the launch to non-associates at market rates for 30 days, and spends two days taking the launch to another port for one of these rentals and then back again to the home port afterwards. She spends one day taking the launch to a boatyard for repair after damage was caused by one of those renters.

Mary's income-earning use is:

- 30 days' rental to non-associates
- 2 days' relocation use
- 1 days' repair use

for a total of 33 income-earning days.

Mary's counted days are:

- 20 days' family use
- 5 days' use by her brother
- 1 days' use by her friend

for a total of 26 counted days.

Mary's apportionment calculation is therefore:

$$\frac{\text{33 income-earning days}}{\text{33 income-earning days} + \text{26 counted days}}$$

$$= \frac{33}{59} = 56\%$$

So Mary can deduct 56% of her mixed-use asset expenditure.

Expenditure quarantining rules

Sections DG 15, DG 19 and DG 20

Background

The fundamental problem that the mixed-use asset rules address is the difficult boundary between expenditure incurred to earn income, which should be deductible against income, and expenditure incurred for private purposes, which should not be. The apportionment method set out above is the key mechanism by which this is done.

However, a tax loss can still arise, notwithstanding the apportionment rule. This is more likely to occur when income-earning use is low, as in the following example:

Income earning use: 15 days at $200 = $3,000 gross income
Private use: 30 days
Expenditure subject to apportionment: $20,000
Deductible expenditure: 15 ÷ 45 × $20,000 = $6,667
Net loss: ($3,667)

A loss in a single year is unexceptional, and many conventional businesses will suffer occasional losses, perhaps as a result of one-off external events. Examples of these kinds of events which might affect a holiday home would be a poor ski season which reduced the demand for ski-field accommodation, or perhaps flood damage to a property which meant it could not be rented out.

However, a loss which recurs from year to year indicates that the apportionment formula has failed to correctly distinguish between expenditure incurred to earn income, and expenditure incurred for private purposes. This is because income would be expected to generally exceed the expenditure incurred to earn that income—with occasional exceptions, such as the examples noted above.

For these reasons, the new rules include a deduction quarantining, or loss ring-fencing rule. Under this rule, a person who is in an occasional loss position will not be able to offset their loss against other income in the current year, but will be able to use it against their future profits from the mixed-use asset. However, a person who is in perpetual loss because the apportionment rule has failed to properly capture all private expenditure will never have future profits to offset the loss against, and the rule amounts to a permanent loss denial.

Detailed rules

The deduction quarantining rules apply only where the income which a person earns from their mixed-used asset is less than 2% of the value of the asset. If the asset is land-based, the 2% is measured against its value for local rating purposes unless the asset has been acquired since that rating value was set. If the asset was acquired after the last ratings valuation, the 2% is measured against the acquisition price so long as it was acquired from a non-associate. If it was acquired from an associate, then the 2% is measured against the market value at date of acquisition. Exempt income (which is income earned from associates or which is less than 80% of market value) does not count towards the 2% test.

For other assets, the 2% is measured against the asset's value for tax depreciation purposes.[3]

Where the deduction quarantining rules apply and the person's expenditure after apportionment exceeds their income, the amount of the expenditure which exceeds the income is not deductible in that income year.

Example

David has a city apartment with a rateable value of $300,000. He rents out the apartment and also uses it privately. He receives a market rate rental of $4,000 from non-associates, and $6,000 from associates. David's total allowable expenditure, following the application of the apportionment rules is $15,000.

The income from associates is exempt under section CW 8B and therefore ignored. David therefore has asset income of $4,000 and deductions of $15,000, giving rise to an excess of expenditure over income of $11,000. Since David's income from non-associates is less than 2% of the apartment's rateable value, the excess expenditure of $11,000 is denied as a deduction.

The quarantined expenditure can be offset against profits in subsequent income years.

Example

In the following income year, David derives $10,000 from renting his city apartment at market rates to non-associates. David's total allowable expenditure following the application of the apportionment rules is $8,000. As calculated above he also has expenditure of $11,000 quarantined from the previous income year. David is able to deduct $2,000 of that quarantined expenditure to bring his profit down to zero. The remaining $9,000 continues to be quarantined and may be allowed as a deduction for a later income year.

[3] Consideration is being given to amending the legislation to set a hurdle rate which is higher than 2% for boats and aircraft from 1 April 2014, which is when these assets become subject to these rules.

There are a number of restrictions around the use of the quarantined deductions in later years:

- The profit must arise from the use of the same asset;
- The profit must arise when that asset is used as a mixed-use asset.

There is one exception to the "same asset" rule—if the asset for which the loss arose is damaged, destroyed, or lost and is no longer held by the person, and the replacement asset is identical or substantially the same as the original mixed-use asset, the loss from the first asset can be offset against subsequent profits from the second asset.

Example

Graeme has a $5,000 quarantined deduction arising from renting out his family bach. Unfortunately it burns down. The insurance company pays out the replacement cost of the bach, which is $350,000. Graeme has a new bach built on the same site at a cost of $350,000. The new bach is of a similar size to the old bach, but has a different layout which allows an extra bedroom and is made of different materials than the old bach, which was built in the 1960s.

Despite the new layout, the extra bedroom, and the use of different materials, the new bach is substantially identical to the old bach, and Graeme can offset the $5,000 quarantined deduction against future profits from renting out the new bach.

There are some situations when it is impractical to apply the deduction quarantining rules. These situations arise when it is too hard to measure whether the income earned from the asset is equal to 2% or more of its value. This can arise when the income-earning use of the mixed-use asset is in a wider business, rather than it being rented out as a stand-alone asset.

However, a small amount of use as part of a business will not exclude the deduction quarantining rule from applying, if the asset is also rented out. So, where the rental use of the mixed-use asset is at least 80% of the income-earning use of the asset, then the deduction quarantining rules will still apply, with the 2% being assessed against the rental income.

Example

Paul uses a helicopter on his farm to check stock for 50 hours in an income year, rents it out for 50 hours, and also uses it privately. While the income from the rental is clear, the income Paul derives in relation to the use of the helicopter in farming operations is not. Paul derives farming income from selling sheep, and it is not possible to attribute any of that income directly to his use of the helicopter in the farming operations. While the helicopter is also rented out, and that income can be clearly identified, the use of the helicopter to earn rental income is only 50% of the total income-earning use of the helicopter. This is less than the 80% threshold. Any loss attributable to the helicopter is therefore not quarantined.

"Opting out" rules

Section DG 21

The new rules entitle some holders of mixed-use assets to treat the asset as being outside the tax system. "Opting out" has the following consequences:

- Income from the asset is not subject to tax.
- No deductions can be claimed for expenditure which relates to the asset.

There are two circumstances in which a person can opt out:

- The gross income from the mixed-use asset (not including income from associated persons or income which is less than 80% of market value) is less than $4,000; or
- The person would otherwise have quarantined deductions.

The decision to opt out is made in each year, and can change from year to year. There are no specific reporting requirements, but as with all other aspects of taxation, the person will need to maintain sufficient records to be able to provide evidence that they were entitled to opt out.

Example

The only income Mike has from the rental of his bach is $3,000 from a person who is not an associated person. Mike can opt out of the rules in this subpart, which would mean that he would not be liable to tax on the amount, but would also not be entitled to claim any deductions in relation to the bach.

A close company which holds a mixed-use asset cannot use these opt-out provisions.

MODIFICATIONS TO GENERAL RULES WHEN ASSETS ARE HELD IN COMPANIES

Additional rules concerning interest deductibility are required when the mixed-use asset is held in a close company, and when shareholders incur interest in relation to their investments in companies. This is because of:

- the rule that most companies can deduct all interest expenditure;
- the rule that shareholders in companies can deduct interest they incur on debt to buy shares.

Without additional rules to apportion interest expenditure it could be more tax advantageous to hold mixed-use assets in corporate structures. Ideally the tax system should not influence a person's decision to hold assets in a particular structure.

The following information sets out variations to the core rules described above which apply when mixed-use assets are held by close companies.

Treatment of interest when an asset is held in a corporate structure

Sections DG 10, DG 11, DG 12, DG 13 and DG 14

This group of provisions sets out specific rules to address the deductibility of interest when the mixed-use asset is held by a company. As well as applying to the company which holds the asset, these rules potentially also apply to shareholders of the company which has the asset (both corporate and individual) and other companies in the same group as the company which has the asset.

The apportionment calculation discussed above remains at the core of the interest rules for companies. The purpose of the rules discussed here is to identify the interest expenditure to which that apportionment calculation ought to apply. The apportionment ratio calculated above applies to all relevant company and shareholder interest expenditure.

Interest deduction for the company which has the mixed-use asset

Section DG 11

This rule applies only to the company that directly holds the mixed-use asset and determines the amount of interest expenditure that is required to be apportioned. In order to do this the company which holds the mixed-use asset needs to determine two amounts:

- **The value of the mixed-use asset ("asset value")**. For land, this is the most recent rating value, or the acquisition cost of the land if more recent and the land was acquired from a non-associated person (if acquired from an associated person, it is the market value at the date of acquisition). For assets other than land, the relevant value is the adjusted tax value for depreciation purposes.
- **The value of the company's debt ("debt value")**, which is the average of its debt at the beginning of the year and the end of the year. All of the company's interest-bearing debt is relevant, not just debt which has some connection with the mixed-use asset.

The asset value is then compared with the debt value.

If the asset value is equal to or more than the debt value, all of the company's interest is subject to apportionment. The amount by which the asset value exceeds the debt value (also known as the net asset balance) will need to be considered further under the provisions which consider group companies and shareholders.

Example

Holiday Home Ltd holds a holiday home which is subject to the mixed-use asset rules and which has a rateable value of $200,000. The company has debt of $40,000, with associated interest expenditure of $4,000. Since the debt value is less than the asset value, all of the $4,000 interest expenditure must be apportioned using the same apportionment formula that applies to the other expenditure relating to the holiday home.

If the asset value is less than the debt value, then apportionment will only apply to a part of the company's interest expenditure. That part is calculated using the following equation:

$$\text{interest expenditure} \times \frac{\text{asset value}}{\text{debt value}}$$

Example

Boat Ltd has a charter boat which has an adjusted tax value of $60,000. The company has debt of $100,000, with associated interest expenditure of $10,000. Since the debt value is more than the asset value, the company must calculate how much of its interest expenditure is subject to apportionment.

The amount of interest expenditure subject to apportionment is $10,000 × ($60,000 ÷ $100,000) = $6,000. Therefore, $6,000 of interest expenditure must be apportioned using the same apportionment formula that applies to the other expenditure relating to the charter boat.

Interest deductions for group companies

Sections DG 10 and DG 12

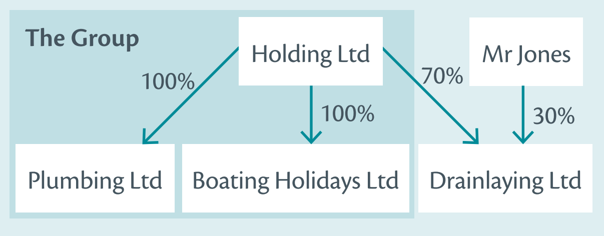
These rules only need to be considered when the asset value exceeds the debt value in the company which has the mixed-use assets under the provisions discussed above.

The rules apply to companies which are in the same group of companies as the company which has the mixed-use asset. The normal tax concept of a group company is used to determine how these rules apply, with two important exceptions:

- a group of companies is treated as a wholly owned group of companies;
- a company which would not ordinarily be part of a wholly owned group of companies, but is treated as part of a wholly owned group of companies under the provision above, is not included in the wholly owned group of companies if no private use of the asset has been made by any shareholder of that company (or a person associated with any shareholder) where the shareholder does not also have interest in the company that owns the mixed-use asset.

Example

Holding Ltd owns 100% of Boating Holidays Ltd, which owns a boat which is a mixed-use asset, and 100% of Plumbing Ltd. Holding Ltd also owns 70% of Drainlaying Ltd, with the other 30% of Drainlaying Ltd being held by a Mr Jones. Plumbing Ltd is part of the group for the purposes of apportionment of interest. Mr Jones does not use the boat, so Drainlaying Ltd is not part of the group for the purposes of apportionment of interest.



Once the relevant group of companies has been identified, the net asset balance from the company which owns the asset (the excess of the value of the asset over debt in that company) is attributed out to group members one at a time.

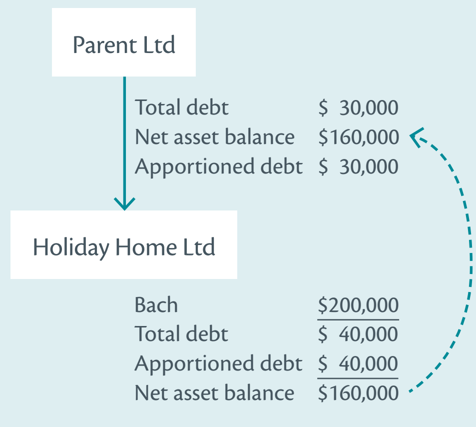
The rules apportion group company interest expenditure in the same way as the company who holds the asset. However, group companies compare their debt value to the net asset balance (instead of the asset value). For example, if the net asset balance is equal to or more than the debt value, all of the group company's interest must be apportioned under the standard apportionment formula. The excess of the net asset balance over debt in that company is the new net asset balance, in which case another group company (if there are any other group companies) then uses the new net asset balance (unless it is nil). This net asset balance is reset every time a company calculation is done by reducing its value by the amount of the particular company's debt value.

If the debt value exceeds the net asset balance the relevant portion of the group company's debt will be subject to apportionment and no further group or shareholder interest apportionment calculations will have to be performed.

The legislation does not prescribe the order in which that attribution takes place—that is a decision to be made by the group.

Example

Holiday Home Ltd has a net asset balance of $160,000 ($200,000 less $40,000) and is wholly owned by Parent Ltd. Parent has debt of $30,000, with associated interest expenditure of $3,000. Since Parent's debt value is less than the net asset balance, all of Parent's interest expenditure must be apportioned.



Note that "apportioned debt" is debt in which related interest expenditure must be apportioned.

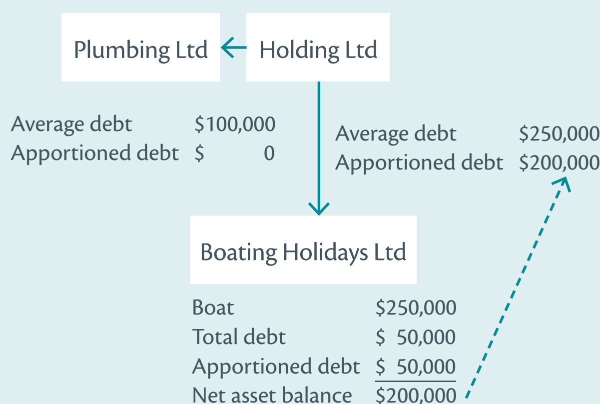
Example

Boating Holidays Ltd's boat has an adjusted tax value of $250,000 and the company has debt of $50,000. Boating Holidays Ltd therefore has a net asset balance of $200,000 to be attributed out to group members.

Plumbing Ltd has average debt of $100,000 and Holding Ltd has average debt of $250,000. The group tax accountant decides to apply apportionment to Holding Ltd's debt. The interest in Holding Ltd which is subject to apportionment is:

$$\frac{\$200{,}000}{\$250{,}000} \times \text{interest expenditure}$$

None of Plumbing Ltd's debt is subject to apportionment.



Interest deductions for corporate shareholders

Sections DG 10 and DG 13

This section applies when a net asset balance (excess of asset value over debt value) remains after identification of debt in the company which owns the asset, and any group companies under the provisions described above. The section identifies debt in corporate shareholders for the purposes of applying apportionment to their interest deductions. Again, the same process is followed to identify interest expenditure that is required to be apportioned by comparing the shareholders' debt value and the remaining net asset balance. However, the net asset balance applied to shareholders is calculated by reference to their voting interest (calculated as if they were the ultimate shareholder) in the company in which they hold shares (or if this is a group company, the net asset value left after all the group company calculations have been done).

The provision contains an ordering rule. Debt is identified in the following order:

- companies (referred to as shareholder companies) which are shareholders in the company which has the mixed-use asset or in a company which is in the same group as the company which has the mixed-use asset, and which have a voting interest in the company which has the asset; then
- companies which have a voting interest in a shareholder company.

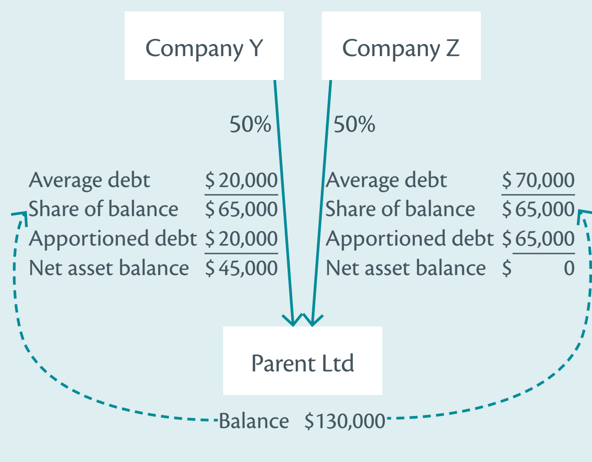
The provisions do not apply to a company which:

- has a direct or indirect interest of less than 50% in the company which has the mixed-use asset; and
- has not enjoyed private use of the asset (eg, by allowing a natural person associated person to use the asset privately).

Example

In an earlier example, Holiday Home Ltd had a net asset balance of $160,000 which it passed on to Parent Ltd. Parent Ltd apportioned interest on debt of $30,000, leaving a net asset balance of $130,000. Parent Ltd has two equal corporate shareholders, Company Y, which has debt of $20,000 with associated interest expenditure of $2,000, and Company Z, which has debt of $70,000 with associated interest expenditure of $7,000. Each company's share of the net asset balance is $65,000 ($130,000 × 50%).

Since Company Y's debt value is less than its share of the net asset balance, all of its interest expenditure must be apportioned. Company Z's debt value is greater than its share of the net asset balance, so the interest it must apportion is calculated as $7,000 × ($65,000 ÷ $70,000) = $6,500.



Interest deductions for non-corporate shareholders

Sections DG 10 and DG 14

These provisions apply when a net asset balance remains after the identification of debt in: the company which owns the asset; any group companies; and any corporate shareholders. They apply to debt held by non-corporate shareholders, and trustees who are companies.

Interest incurred by a non-corporate is only subject to apportionment if the debt was incurred to acquire the shares in a company which:

- has the asset;
- is a shareholder in the company which has the asset;
- has a voting interest in the company which has the asset;
- is a shareholder in a company which is in the same group as the company which has the asset, and has a voting interest in it.

However, the rules will not apply when the person has a direct or indirect interest of less than 50% in the company, and did not have any private use of the asset.

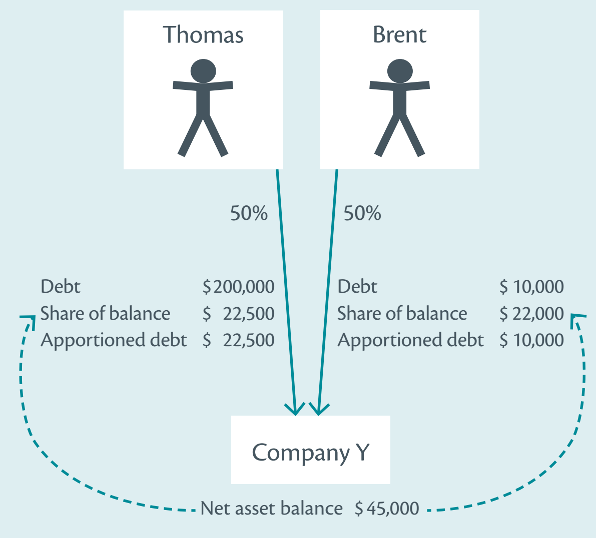
The person's share of the net asset balance is calculated by reference to their voting interest in the company in which they own shares, which in turn must have a direct or indirect interest in the mixed-use asset owning company.

Example

In an earlier example, Company Y's share of Parent Ltd's asset balance was $65,000 and it had debt of $20,000. Company Y therefore has a net asset balance of $45,000 to be distributed amongst its shareholders. Company Y has two shareholders: Thomas, who has borrowed $200,000 to acquire a 50% interest in the company, and Brent, who has borrowed $10,000 to buy his 50% interest. Each has a share of the remaining net asset balance of $22,500.

The formula is ($65,000 − $20,000) × 50% = $22,500.

Since Thomas' debt value is greater than his share of the net asset balance, Thomas must apportion 11.25% of his total interest expenditure. The formula is 22,500 ÷ 200,000. Since Brent's debt value of $10,000 is less than his share of the net asset balance of $22,500, all Brent's interest expenditure must be apportioned. Obviously apportionment stops at the level at which the shareholder is not a company.



Deduction quarantining rules when an asset is held in a corporate structure

Sections DG 15–DG 19

Additional rules are provided to deal with deduction quarantining when the mixed-use asset is held in a company. Interest deductions identified in a group company or shareholder under the provisions discussed above may be subject to quarantining.

The rules need to be considered when the gross income from the asset is less than 2% of its value as discussed above. For reasons set out below, whether income exceeds apportioned expenditure in the company holding the asset is not relevant.

The first step is to calculate the difference between the income earned from the asset and the apportioned expenditure in the company which has the asset. If expenses in that company exceed its income—that is, it is itself in loss and subject to deduction quarantining—then the apportioned interest expenditure identified in all group companies and shareholders will also be subject to quarantining.

If the income in the company which has the asset exceeds its expenses—that is, it is in "profit", described in the legislation as having an "outstanding profit balance"—then to the extent possible, that profit will be notionally allocated to those group companies and shareholders which had apportioned interest, in amounts equal to their apportioned interest amounts (and in the same order in which those various persons had debt apportioned). To the extent an apportioned interest amount can be matched with "profit", then it will be deductible against other income in the company (or if none, available to be carried forward as an ordinary, unrestricted loss). There is no obligation to offset the interest amount against income from the company which holds the mixed-use asset.

However, once all of the "profit" has been exhausted and none remains to be allocated against an interest amount, then that interest amount will be quarantined and not able to be deducted in the current year.

Quarantined amounts will be carried forward to future years, and will be deductible where they can be notionally matched with an amount of "profit" from future years from the company which has the mixed-use asset.

Example

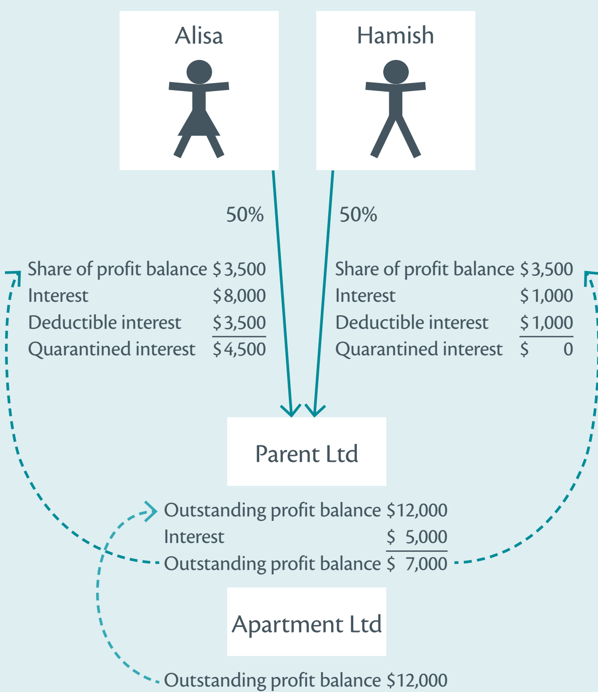
Apartment Ltd owns an apartment to which the rules in this subpart apply and the income derived from the asset in the current year is less than 2% of the cost of the apartment. The company has calculated an outstanding profit balance of $12,000 as a result of deducting its apportioned expenses from its income from the apartment. Apartment Ltd is 100% owned by Parent Ltd, which has interest expenditure, after apportionment, of $5,000.

Parent Ltd has two equal shareholders, Alisa who has apportioned interest expenditure of $8,000, and Hamish who has apportioned interest expenditure of $1,000.

Parent Ltd is the first entity subject to the deduction quarantining rules. Its apportioned interest expenditure of $5,000 is less than the outstanding profit balance of $12,000, so it is not required to quarantine any of its interest expenditure. However, the outstanding profit balance is reduced to $7,000 ($12,000 – $5,000).

Because Alisa and Hamish are equal shareholders their share of the $7,000 outstanding profit balance is $3,500 each ($7,000 × 50%). Alisa can therefore deduct $3,500 of her $8,000 apportioned expenditure, but must quarantine the remaining $4,500 ($8,000 – $3,500).

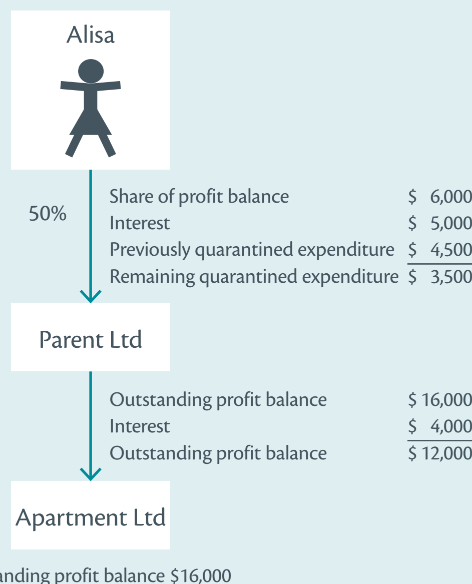
Hamish has the same entitlement to deduct $3,500 of his apportioned expenditure but only has $1,000 of apportioned expenditure anyway, so is able to deduct all of it. The $2,500 remaining after Hamish has done that is not used.



In terms of allocating Alisa's quarantined expenditure, she is able to deduct that quarantined expenditure in a future income year to the extent there is an outstanding profit balance in that future year.

For example, in the following income year, Apartment Ltd has calculated an outstanding profit balance of $16,000 after deducting apportioned expenditure from the income from the apartment. In that same year, Parent Ltd has apportioned interest expenditure of $4,000 and Alisa has apportioned interest expenditure of $5,000.

Therefore, Parent Ltd can claim all of its apportioned interest expenditure and an outstanding profit balance of $12,000 remains ($16,000 – $4,000). Alisa's share of the outstanding profit balance is $6,000 ($12,000 × 50%) and therefore she can claim her current year apportioned interest expenditure of $5,000, and can claim $1,000 of her previously quarantined expenditure. Alisa's remaining $3,500 of quarantined expenditure remains quarantined.



Transitional rule to allow companies to transfer assets to shareholders

Section DZ 21

The purpose of this rule is to facilitate the restructuring of arrangements under which mixed-use assets are held in companies. This rule allows the mixed-use asset to be transferred out to shareholders without triggering any depreciation recovery.

A company can choose to apply this rule when:

- on 31 March 2013 it has a mixed-use asset;
- it transfers the asset to its shareholders (or to the shareholders of its shareholders) in proportion to their shareholding.

The transfer must be made before the end of the company's 2013–14 income year.

The transfer of the asset is treated as if it were a disposal and acquisition of the asset for an amount equal to the adjusted tax value of the asset on the date of the transfer. This means that no depreciation recovery will be triggered by the transfer. The policy intention is that the shareholder steps into the shoes of the company and so will be liable for any depreciation recovery on eventual disposal of the asset as if they had claimed all of the depreciation which the company had claimed.

If the asset is transferred to a shareholder for less than market value, a dividend may arise.

Example

BoatCo Ltd has a boat on 31 March 2013 which meets the various requirements set out in subpart DG. All the shares in BoatCo Ltd are owned by Michelle. The boat has a market value of $75,000, and an adjusted tax value of $55,000.

BoatCo Ltd transfers the boat to Michelle without payment (which is treated as a dividend of $75,000). For depreciation purposes, BoatCo Ltd is treated as disposing of the boat for $55,000, and Michelle is treated as acquiring it for $55,000.

MISCELLANEOUS TECHNICAL AMENDMENTS

Assets owned by qualifying companies

The general rule for companies that states that interest on all debt is deductible, regardless of the use of that debt, does not apply to qualifying companies. Qualifying companies are instead required to identify the use of their debt to determine whether interest on it is deductible or not—a tracing rule. The mixed-use asset rules recognise this approach by excluding qualifying companies from the interest apportionment rules which apply to companies, and instead apply apportionment only to interest on debt which relates to the mixed-use asset (see section DG 5(2)).

However, as with ordinary companies, it may also be necessary to consider debt incurred at a group company or shareholder level. A qualifying company is therefore required to calculate a net asset balance in the same way as an ordinary company, and the same rules for attributing that to group companies and shareholders also apply.

Relationship between the mixed-use assets rule and other provisions

Section DG 2

The mixed-use asset rules override various provisions in subpart DB which deal with the deductibility of interest and financing expenditure. This override is necessary because the mixed-use asset rules limit deductions for interest and financing expenditure that would otherwise be able to be claimed.

The rules in subpart DD which limit deductions for entertainment expenditure do not apply to expenditure incurred in relation to the private use of an asset under the mixed-use asset rules.

Where the use of an asset is private use under the mixed-use asset rules, no liability to fringe benefit tax will arise. The choice which is normally available to treat a benefit provided to a shareholder/employee as either a fringe benefit or a dividend is specifically disabled, and the use is required to be treated as a dividend.

The use of an asset by a shareholder may constitute both private use under the mixed-use asset rules and a deemed dividend (if, for example, less than market value is paid for the use of the asset). This is consistent with the position under ordinary law—which is well-understood for cash dividends—that no deduction is available for the amount outlaid to pay a dividend. In a dividend context, the mixed-use asset rules are merely the mechanism by which the cost of providing the non-cash dividend is calculated.

Where an asset is acquired or disposed of during the income year

Section DG 22

Various rules are provided to deal with assets being acquired or disposed of during the course of the income year. These rules:

- pro-rate the 62-day test used to determine whether an asset is a mixed-use asset;
- set appropriate days to measure the debt value of companies;
- pro-rate interest expenditure which companies are required to apportion; and
- pro-rate the 2% threshold to determine whether losses are subject to ring-fencing.

Notice requirements

Section 30D is added to the Tax Administration Act 1994 to provide that a company subject to the missed-use assets rule must give appropriate notice to its shareholders.

MIXED-USE ASSETS: GST CHANGES

Sections 20(3JB), 20G, 21B, 21D and 21G of the Goods and Services Tax Act 1985

Summary of proposed amendments

Changes are being made to the Goods and Services Tax Act 1985 consistent with those being made in the Income Tax Act 2007 for mixed-use assets (ie, land (including improvements), aircraft and boats). It is important to note that the GST changes will apply only to GST-registered persons. These changes however do not apply to a widely-held company (see section 20G(8)).

These changes will ensure that mixed-use asset owners that are registered for GST will be able to claim input tax deductions in a similar way as they would be able to claim income tax deductions for the same item.

Some GST-specific rules are required to cater for the fact that:

- GST has always recognised that supplies can be made for below-market value to non-associates.
- An asset will have a GST component that will need to be apportioned over the ownership period (whereas for income tax purposes this would be capital expenditure).
- Some items of expenditure relevant for the income tax calculation will not be relevant for GST (such as interest).
- GST is not calculated on an annual basis.

Application dates

The GST changes are broadly aligned with the income tax changes. For assets for which the income tax changes take effect from the 2014–15 income year (ie, aircraft and boats), the GST changes will apply from 1 April 2014.

However, for assets for which the income tax changes take effect from the 2013–14 income year (ie, land (including improvements)), the GST changes will only apply from 17 July 2013 (the date of Royal assent of the Act).

Key features

Owners of mixed-use assets will, under the proposed changes, be required to apportion their input deductions in a way that reflects their relative taxable and non-taxable use of the asset. This is consistent with the proposed treatment of income tax deductions.

The formula used for calculating GST deductions (contained in new section 20G) incorporates the income tax definitions as far as possible. Having the GST calculations as close as possible to those for income tax is intended to reduce the compliance costs associated with the proposed rules.

The main differences between the income tax and GST definitions relate to:

- the treatment of supplies for less than market value; and
- what constitutes "expenditure".

These differences reflect the different nature of the two taxes. In particular:

- GST has always recognised the right of registered persons to make supplies for lower than market value to non-associates.
- "Expenditure" is not a word generally used in a GST context, so the GST formula replaces "expenditure" with "input tax".

Below market value supplies

The definition of "income-earning days" in the GST formula includes any day on which the person supplies the asset for use and derives consideration, irrespective of whether this supply is above, at or below market value. This allows asset owners to make supplies at below market value if they chose to do so, with these days still being "income earning". This is consistent with general GST principles.

It is important to note that, if the owner supplies the asset to an associated person, section 10(3) will generally require them to treat the supply as being made at market value. This will require output tax to be paid on the supply, but it will also be treated as "income-earning" for the purposes of calculating entitlement to input deductions. Similarly, if the supply is a fringe-benefit, section 21I will apply to deem consideration to have been received—this will also be an income-earning day.

"Expenditure"

The replacement of expenditure for input tax ensures that GST deductions are based on what the GST Act allows. Expenditure on some assets will be subject to GST, but irrelevant for income tax purposes. The most obvious example is likely to be the main mixed-use asset itself, which may have a GST component (either explicitly or through the secondhand goods rules). It is also to clarify that input tax on durable assets (such as a holiday house) is relevant for each subsequent adjustment period in the same way as it is for the general apportionment rules. On the other hand, interest is a relevant expense for income tax but not for GST purposes.

Rules in practice

Link with apportionment rules

As mixed-use assets are used partly for private and partly for business purposes, the general apportionment rules in the GST Act should also apply to expenditure in relation to these assets. To facilitate this, the definitions used in the apportionment rules: "percentage intended use", "potential actual use" and "percentage difference" in section 21G have been extended to apply to the mixed-use asset formula in section 20G.

The effect of this change is that a GST-registered recipient of a supply in respect of their mixed-use assets will need to perform an initial estimate of their percentage intended use of the supply. This estimate should be done based on the result the person thinks the formula in section 20G would produce. In calculating this, an asset owner will need to be aware that the section does not apply to supplies used solely for income earning days or solely for private days. If a supply is used solely for income earning days, all input tax is deductible and no apportionment is necessary. Conversely, if a supply is used solely for private days, no input tax is deductible.

As with the general apportionment rules and the formula used for income tax, section 20G requires a registered person to perform annual calculations to determine the level to which they can claim input tax deductions. As with the general apportionment rules, section 20G requires the registered person to pay any output tax or allow them to claim input tax on any positive or negative adjustment produced by the formula.

Filing

One issue specific to GST is that GST is not generally calculated on an annual basis, so GST-registered owners of mixed-use assets will be required to file returns on a monthly, two-monthly or six-monthly basis. Although the general apportionment rules provide for annual adjustments, section 20G sets put specific rules for the calculation and what to do for intervening taxable periods.

Section 20G requires a person to perform the calculation at the end of an adjustment period, as defined. This is usually an annual period. However, as stated above, the registered person must estimate their taxable use of a supply in the intervening periods and calculate their actual taxable use at the end of each adjustment period. This wash-up calculation will determine the person's true tax position for each of the taxable periods within the adjustment period.

To ease the compliance burden on registered persons, the rules require input tax in the adjustment period to be aggregated. Only if the estimated deductions are 10 percentage points or greater than the actual taxable use (or less than 10 percentage points but more than $1,000) is a wash-up necessary (see section 20G(6)).

An alternative approach, which ensures greater accuracy but that might reduce cash-flow, would be for the registered person to delay claiming input deductions in the intervening periods and instead claim their annual entitlement at the end of each adjustment period when the calculation is performed.[4]

Disposal

Section 20G(7) provides that the disposal of the relevant asset by a registered person will be a taxable supply and section 21F will apply to it. This means that output tax will be payable on the disposal and a registered person will be able to apply the section 21F formula to claim any input tax not previously claimed.

Note: Some examples used in the legislation do not always reflect the correct amounts. These will be corrected in the tax bill scheduled to be introduced in late October 2013.

[4] Section 20(3) allows deductions from output tax to be claimed anytime up to the second anniversary of the relevant supply.

SHORT-TERM CHANGE FACILITIES AND FBT

Sections CX 25 and RD 39 of the Income Tax Act 2007

Background

Charitable organisations are generally exempt from fringe benefit tax on benefits provided to their employees. Currently, one exception to this exemption is when the charitable organisation provides a benefit to an employee by way of a short-term charge facility, and the value of the benefit for the employee in a tax year is more than 5% of the employee's salary or wages for the tax year.

Various arrangements have been offered to employees of charitable organisations which involve the provision of vouchers instead of salary, which has raised the question of whether a voucher constitutes a "short-term charge facility".

Key features

Two changes have been made to section CX 25 of the Income Tax Act 2007.

- The first change amends the threshold above which the benefit provided under a short-term charge facility will be a fringe benefit.
- The second change clarifies that items such as vouchers are capable of being short-term charge facilities.

A consequential change has been made to paragraph CX 25(3)(b).

A consequential change has also been made to section RD 39.

Detailed analysis

Other income (business income)

The first change is to subsection CX 25(2) and ensures that the exemption threshold is set at a level that recognises potential compliance costs but protects the revenue base. The current threshold is 5% of the employee's salary or wages for the tax year. The revised threshold means that a fringe benefit will arise if the aggregate value of the short-term charge facility benefits provided by the charitable organisation to the employee in a tax year is more than the lesser of:

- 5% of the employee's gross salary or wages for the tax year, or
- $1,200.

The second change is to paragraph CX 25(3)(a). It clarifies that an arrangement which enables an employee to obtain goods or services which have no connection with their employer or their employer's operations by providing consideration other than money for the goods or services can constitute a short-term charge facility. Previously, the provision only referred to arrangements which enable the employee to obtain such goods or services by either buying or hiring those goods or services, or by charging the cost of the goods or services to an account.

The change to paragraph CX 25(3)(b) is intended to clarify that an employer who provides payment or other consideration for the goods or services can do so at any time. This amendment was in response to submissions which questioned whether there could be any liability placed on the employer (the current wording) if, for example, an employer had already paid for a short-term charge facility before providing it to an employee.

Application date

The amendments apply from 1 April 2014.

FAMILY SCHEME INCOME FROM EMPLOYMENT BENEFITS

Sections MB 7B and MB 8 of the Income Tax Act 2007

Background

"Family scheme income" is used to calculate entitlements and obligations for a number of different forms of social assistance. A key principle of tax policy is horizontal equity. In the context of social assistance, this means that entitlements to, for example, Working for Families tax credits should apply equally to people on the same effective income. Inequity arises when a non-cash benefit is provided as a substitute for salary or wages, if it is not included in family scheme income in the way that salary or wages would be.

This amendment will see certain types of non-cash benefits taken into account for Working for Families tax credits, the student allowances parental income threshold, and community services card entitlements.

Key features

New section MB 7B requires employees who receive certain non-cash benefits to include them in their family scheme income calculations as follows:

- The availability of an employer-provided motor vehicle for an employee's private use is included if it is part of an explicit salary trade-off—that is, if the employee would be entitled to a greater amount of employment income if they chose not to receive the non-cash benefit.
- An employee who receives short-term charge facilities will also be required to include these if the value of benefits received in a year is more than the specified threshold in section CX 25(3). This applies to any employee, not just those employees who work for charitable organisations.

Section MB 7(2) sets out the amounts which must be included in a person's family scheme income, if they receive one of the benefits referred to above.

- For a motor vehicle which is made available for the person's private use, the amount to be included is the amount by which their employment income would be increased in the absence of that benefit.
- For short-term charge facilities to be included their aggregate value for a person in the relevant income year must be above a threshold. That threshold is the lesser of 5% of the employee's salary or wages, or $1,200. The amount to be included is the aggregate value of all short-term charge facility fringe benefits, including fringe benefit tax.

As a consequence, the title of section MB 8 has been amended to avoid confusion with new section MB 7B.

Detailed analysis

It is important to note that section MB 7B applies to all employees, not merely employees of charitable organisations.

When explaining the concept of an explicit salary trade-off, section MB 7B(1)(b) uses the phrase "the person would be entitled to a greater amount of employment income should the person choose, or have chosen, not to receive the benefit".

The inclusion of the clause "or have chosen" is not intended to signify that a fringe benefit will arise where a person was offered such a choice and chose the greater amount of employment income. Instead, it is intended to refer to situations where the person has previously been offered a choice between the benefit and a greater amount of employment income, has chosen the benefit, and would not receive a greater amount of employment income if they now chose to not receive the benefit.

The short-term charge facilities may be provided by multiple employers. Therefore an employee who receives short-term charge facility fringe benefits from more than one employer during the tax year will need to aggregate their benefits to determine whether the aggregate value of those benefits is greater than the threshold.

Application date

The amendments apply from 1 April 2014.

FRINGE BENEFIT VALUE WHEN PAYMENT MADE BY EMPLOYEE

Section RD 54(2) of the Income Tax Act 2007

Background

This subsection sets out that the value of a fringe benefit is reduced by the amount an employee pays to receive that fringe benefit.

Key features

A technical amendment has been made to section RD 54(2) to ensure that the net value of a benefit cannot be a negative number if the employee pays an amount which is greater than the value of the relevant fringe benefit.

Application date

The amendment applies from 1 April 2014.

LEASE INDUCEMENT AND LEASE SURRENDER PAYMENT MEASURES

Sections CC 1B, CC 1C, DB 20B, DB 20C, EA 3, EI 4B and YA 1 of the Income Tax Act 2007

The tax treatment of land-related lease inducement and lease surrender payments has been reformed for income tax purposes. Lease inducement and lease surrender payments are treated as taxable income to the recipient and deductible to the payer under the Income Tax Act 2007. The reforms are intended to make the tax treatment of lease-related payments fairer and more efficient for businesses, by removing a tax advantage that under the previous rules had the effect of distorting business decisions on leases.

Background

The New Zealand tax system generally maintains the capital-revenue boundary: capital receipts are generally not taxed, whereas revenue receipts are taxed. The boundary, however, became problematic in the context of certain land-related lease payments.

Following the recent economic downturn, arrangements involving lease inducement payments became a popular option for landlords to attract tenants without needing to reduce the rental amounts payable. Lease inducement payments are unconditional lump sum cash payments generally made by landlords to induce tenants to enter into a commercial lease.

In the absence of specific provisions in the Income Tax Act 2007, lease inducement payments, for income tax purposes, were characterised differently for a payer and a recipient. They were generally non-taxable to a recipient (tenant) and generally deductible to a payer (a commercial landlord who is in the business of leasing). The capital nature of a lease inducement payment was confirmed by the Privy Council in *Wattie*.[5]

Under the previous rules, the tax treatment of lease inducement payments in a commercial context posed a risk to the tax base. It created an opportunity for taxpayers to substitute tax deductible rent payments with non-taxable cash lease inducement payments. Also, compared with other forms of lease inducements such as a rent-free holiday or a contribution towards fit-out costs, these payments provided a tax advantage which distorted business decisions on leases. To address the revenue risk, an officials' issues paper, *The taxation of lease inducement payments*, was released in July 2012, containing a proposal to tax lease inducement payments.

In response to concerns raised in submissions, the Government decided to extend the scope of the reform by including another type of lease payment—lease surrender payments. Lease surrender payments that are generally made by tenants to landlords to surrender existing lease arrangements were treated differently to lease inducement payments for income tax purposes. They were typically taxable to the recipient (commercial landlord) and non-deductible to the payer (tenant). The latter treatment was confirmed by the Court of Appeal in *McKenzies*.[6]

[5] *Commissioner of Inland Revenue v Wattie* [1999] 1 NZLR 529.

[6] *Commissioner of Inland Revenue v McKenzies New Zealand Limited* [1988] 2 NZLR 736.

Lease surrender payments were regarded as "black hole" expenditure to the commercial tenant—that is non-deductible business expenditure.

Lease surrender payments can also be made by landlords to tenants to surrender existing lease arrangements and, in this case, the payments were typically non-taxable to the recipient (tenant) and deductible to the payer (commercial landlord).

The lease inducement and lease surrender payment reforms were the first stage of the two-stage reform process for reforming the taxation of land-related lease payments. The second stage of the reform reviewed the overall tax treatment of land-related lease payments, such as lease transfer payments. An officials' issues paper, *The taxation of land-related lease payments*, was released in April 2013.

Key features

The changes fall into two groups. The first group includes amendments relating to the tax treatment of lease inducement payments, namely the charging provision (new section CC 1B), the deduction provision (new section DB 20B), and the timing provision (new section EI 4B). The second group includes amendments relating to the tax treatment of lease surrender payments, namely the charging provision (new section CC 1C) and the deduction provision (new section DB 20C).

Under the amendments relating to lease inducement payments:

- If a person (the payee) derives an amount as consideration for the agreement by the payee to the grant, renewal, extension, or transfer of a right (the land right) that is a leasehold estate or a licence to use land, the amount is taxable to the payee (new section CC 1B).
- A related deduction provision is provided (new section DB 20B).
- A new timing rule allocates the income and deductions from section CC 1B and DB 20B evenly over the period of the land right. An exception applies when the person ceases to hold the relevant land right, or the estate in land from which the land right is granted, during an income year. For income, the remaining amount to be spread under the general timing rule is allocated to that income year. For deductions, the remaining amount to be spread is allocated to that income year if the land right, and the estate in land from which the land right is granted, are not held by the person or an associated person (new section EI 4B).

Under the amendments relating to lease surrender payments:

- If a person (the payee) derives an amount as consideration for the agreement by the payee to the surrender or termination of a land right (the land right) that is a leasehold estate or licence to use land, the amount is taxable to the payee (new section CC 1C).
- A related deduction provision is provided (new section DB 20C).
- There is no specific timing rule for lease surrender payments. The general principles and provisions of the Income Tax Act 2007 apply to determine the timing of income and deductions for lease surrender payments. Generally, income and deductions arising from lease surrender payments are allocated to the income year in which an amount is derived or incurred.

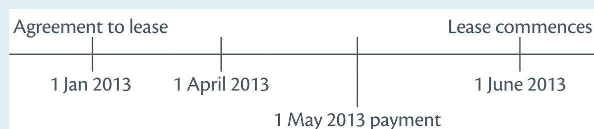
Application dates

The amendments relating to lease inducement payments (new sections CC 1B, DB 20B and EI 4B) apply to an amount that is derived or incurred on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred, on or after that date. A lease includes an agreement to a lease.[7]

The amendments relating to lease inducement payments do not apply to an amount that is derived or incurred on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended or transferred, before 1 April 2013.

Example

A landlord and a tenant entered into a binding lease agreement on 1 January 2013. The landlord is liable to pay the tenant $100,000 on 1 May 2013 for the agreement to a lease. The lease commences on 1 June 2013.



The amendments relating to lease inducement payments do not apply to the $100,000 payment derived by the tenant. The lease is entered into before 1 April 2013 even though the payment is derived after the 1 April date. The tax treatment of the $100,000 lease inducement payment is determined under the general principles and provisions in the Income Tax Act 2007.

The amendments relating to lease surrender payments (new sections CC 1C and DB 20C) apply to an amount that is derived or incurred on or after 1 April 2013.

[7] The definition of "lease" in section YA 1 of the Income Tax Act 2007 is defined as a disposition that creates a leasehold estate. The definition of "leasehold estate" includes any estate, however created, other than a freehold estate. The definition of "estate" includes both a legal or equitable estate as well as a right to the possession of the land.

Detailed analysis

Tax treatment of lease inducement payments

Income

New section CC 1B provides that if a person (the payee) derives an amount as consideration for the agreement by the payee to the grant, renewal, extension or transfer of a land right, the amount is taxable to the payee. The land right must be a right that is a leasehold estate or a licence to use land.

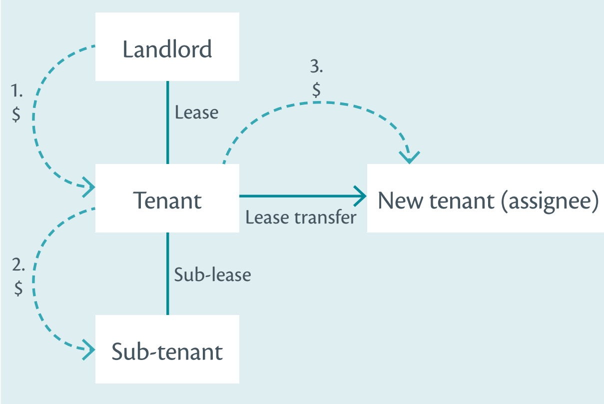
The term "leasehold estate" is defined broadly in section YA 1 to include any estate, however created, other than a freehold estate.[8] The charging provision, therefore, does not apply to payments from a freehold estate in land, such as the proceeds from the sale of land.

The charging provision applies broadly because it only focuses on the person who receives the payment—the payee. The payer is not relevant. If a person receives a lease inducement payment on behalf of another person, the existing nominee rules in section YB 21 apply to treat the amount as derived by that other person.

Example

Examples of payments that are taxable under section CC 1B include:

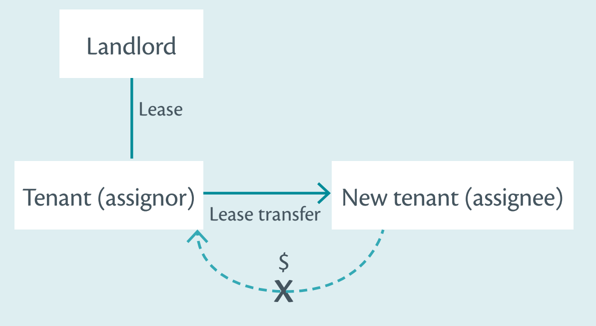
- a payment from a landlord (lessor) to a tenant (lessee);
- a payment from a tenant (sub-lessor) to a sub-tenant (sub-lessee); or
- a payment from a tenant (assignor) to a new tenant (assignee).



The charging provision does not apply to an amount derived by the payee as the holder of a land right and as consideration for the transfer of the land right to the person paying the amount (section CC 1B(2)).

Example

A lease transfer payment received by an assignor from an assignee for the assignment of an existing lease is not taxable under section CC 1B.



The reference to "amount" in section CC 1B uses the definition of "amount" in section YA 1, which includes any amount in money's worth. The charging provision therefore includes consideration other than cash.

Note that some land-related lease payments can be subject to more than one income-charging provision in the Income Tax Act 2007. For example, lease premiums are taxable under sections CC 1 and CC 1B and contributions for fit-out costs are taxable under sections CC 1B and CG 8. However, the tax treatment of amounts that are already subject to sections CC 1 and CG 8, which relate to income from land or capital contributions respectively, do not change. The amount is included in income only once (section BD 3(6)) and the new timing rule for lease inducement payments in section EI 4B does not apply to an amount that is income under section CC 1 and CG 8 (section EI 4B(2)).

Exception for a tenant or a licensee of residential premises

An exception for a tenant or a licensee of residential premises applies. The amount is not considered income if the payee is a natural person (individual) and derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission.

This exclusion is intended to provide a consistent tax treatment of income and deductions for a tenant or a licensee of residential premises. An individual tenant or a licensee of residential premises is not allowed a deduction for payments of rent because they do not meet the general permission in section DA 1 and the private limitation in section DA 2(2). On the other hand, an accommodation provider, who is not a natural person, is subject to section CC 1B because they would typically be allowed a deduction for payments of rent under the general permission.

[8] For income tax purposes, an interest in land has the same meaning as an estate in land.

If there is a concurrent use of the land right for residential and business purposes, the amount is apportioned accordingly. The amount relating to business purposes is taxable under section CC 1B to the extent that a tenant or a licensee whose expenditure on the premises is allowed a deduction under the general permission in section DA 1.

Deductions

New section DB 20B provides that lease inducement payments are deductible to a person (the payer) if the following conditions are met:

- a person (the payer) incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the grant, renewal, extension or transfer of a right (the land right) that is a leasehold estate or a licence to use land;
- the payer is the person who owns the land right or the estate in land from which the land right is granted; and
- the payee is the person who is obtaining the land right.

The deduction provision allows deductions for other forms of lease inducements, in particular, contributions for fit-out costs. A consequence of this is that the timing rule for deductions in new section EI 4B (discussed below) applies to these payments.

New section DB 20B overrides the capital limitation in section DA 2(1). The general permission in section DA 1 must still be satisfied and the other general limitations in section DA 2 still apply.

Timing of income and deductions

New section EI 4B is a timing provision for lease inducement payments. The timing provision applies to the amount of income under section CC 1B or deductions under section DB 20B that is derived or incurred in relation to:

- a right (the land right) that is a leasehold estate or a licence to use land; and
- a period (spreading period).

The "spreading period" means a period that:

- begins with the commencement, or a renewal or extension, of the land right; and
- ends before the earliest following date on which the land right may be terminated, or may expire, if not extended or renewed.

In other words, the spreading period is an initial fixed period set either at the grant, renewal or extension of the land right. The rationale for this approach is to avoid complexities around adjusting the spreading period (and relevant income and deduction allocations) when the initial fixed period is later modified, renewed or extended. If there is a payment for a renewal or extension of the land right, the payment is spread over the fixed renewal or extension period because that period is regarded as a separate spreading period.

Example 1

A landlord and a tenant enter into a 5-year lease, which includes two 5-year renewal rights. The lease commences on 1 April 2013. On the same day, the tenant receives a lease inducement payment from the landlord.

The spreading period of the lease inducement payment, which is subject to sections CC 1B and DB 20B, is from 1 April 2013 (being the commencement date of the lease) to 31 March 2018 (being the earliest following date on which the lease expires).

Example 2

Following on from the above example, in March 2018, the tenant decides to renew the lease for another 5 years (from 1 April 2018 to 31 March 2023). In January 2022, there is an oversupply of leases in the market. The tenant wants to move to other premises for a lower rent. Knowing this, the landlord makes a lease inducement payment to the tenant for the renewal of the lease for another 5 years (from 1 April 2023 to 31 March 2028). The tenant renews the lease for another 5 years.

The spreading period of the second lease inducement payment is from 1 April 2023 (being the commencement date of the second renewal period) to 31 March 2028 (being the earliest following date on which the lease expires). Although the payment was made in January 2022, the tenant derives the payment in relation to the second renewal period of the lease.

Section EI 4B(3)(a) allocates income and deductions for lease inducement payments. The amount of income and deductions is allocated proportionately to the number of months in an income year over the spreading period.

Given that lease inducement payments are generally made at the commencement of a land right, the amount is allocated evenly over the spreading period. Even when the amount is derived or incurred before the commencement of the land right, the amount is allocated in relation to the spreading period, not when the amount is incurred or derived.

Example

On 1 April 2013, a tenant receives $100,000 from a landlord as consideration for the agreement to enter into a 10-year lease that commences on the same day. The tenant and the landlord both have a 31 March balance date.

The tenant

Under section CC 1B, $100,000 is taxable to the tenant. Under section EI 4B, the income is spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (ie, $10,000 income is allocated to the tenant in each income year).

The landlord

Under section DB 20B, $100,000 is deductible for the landlord. Under section EI 4B, the deductions are spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (ie, a deduction of $10,000 is allocated to the landlord in each income year).

The allocation of income and deductions for lease inducement payments is affected by when the income or expenditure is derived or incurred in relation to the spreading period. For example, if the amount is derived or incurred half-way through the spreading period, the amount is spread evenly over the remaining spreading period. If the amount is derived or incurred at or after the end of the spreading period, the amount is allocated to the income year in which it is incurred or derived.

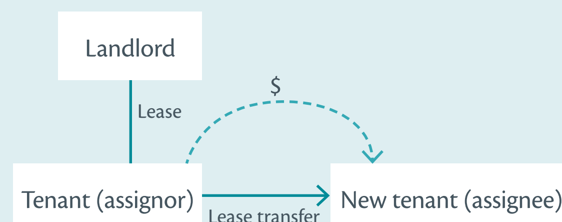
If the spreading period is more than 50 years, the amount is allocated evenly over the first 50 income years (section E 4B(3)(a)(iii)).

Note that, under the timing provision, an amount of expenditure incurred by an assignor to induce an assignee to receive an assignment of a lease is allocated to the income year in which the amount is incurred. By assigning the lease, the assignor has no remaining period over which to spread the expenditure. On the other hand, the assignee spreads the amount of income evenly over the remaining period of the lease.

Example

On 1 April 2014, a tenant enters into a 10-year lease. However, after three years, the tenant finds that their business is not doing well and finds the lease burdensome.

The tenant becomes aware that A Ltd is looking for premises. The tenant is keen for A Ltd to take the lease. On 1 October 2017, the tenant pays $30,000 to A Ltd to transfer the lease from that date.



The timing of income and deductions for the tenant and A Ltd under section EI 4B is illustrated in the table below. The tenant and A Ltd have a 31 March balance date.

Income year	The tenant (assignor)		A Ltd (assignee)	
	Deduction	Income	Deduction	Income
2014–15	–	–	–	–
2015–16	–	–	–	–
2016–17	–	–	–	–
2017–18	$30,000	–	–	$2,308
2018–19	–	–	–	$4,615
2019–20	–	–	–	$4,615
2020–21	–	–	–	$4,615
2021–22	–	–	–	$4,615
2022–23	–	–	–	$4,615
2023–24	–	–	–	$4,615

The timing provision does not apply to an amount that is treated as income under section CC 1 or CG 8, which relate to income from land or capital contributions respectively. Income under section CC 1 is taxable when derived unless the timing rule in section EI 7 applies. Income under section CG 8 is spread evenly over 10 years unless the payee chooses to reduce the cost base of the depreciable property under section DB 64.

The following example explains how the timing provision would apply to a contribution towards the cost of a fit-out.

Example

On 1 April 2013, a tenant receives a lease inducement payment of $100,000 from its landlord to enter into a 12-year lease. The terms and conditions of the agreement require that the tenant must use the payment for a fit-out of their lease premises.

The tenant spends a total of $300,000 on its fit-out in the 2013–14 income year. The tenant and the landlord both have a 31 March balance date.

The tenant

The tenant can either choose to return $100,000 as income over the next 10 years, starting from the 2013–14 income year, or reduce the cost base of the fit-out by $100,000. Under the latter option, the tenant is only able to claim depreciation on the remaining $200,000 of expenditure incurred on the fit-out.

The landlord

The landlord is allowed a deduction of $100,000 under section DB 20B, which is allocated under section EI 4B over the 12-year period from the 2013–14 to the 2024–25 income years inclusive (ie, a deduction of $8,333 is allocated to the landlord in each income year).

Disposal of the land right part-way through the spreading period

An exception applies to the new timing rule if the person ceases to hold the relevant land right or the estate in land from which the land right is granted. Generally, a "wash-up" calculation of income and deductions is allowed if a person ceases to hold the land right or the estate in land from which the land right is granted, part-way through the spreading period (section EI 4B(4) and (5)).

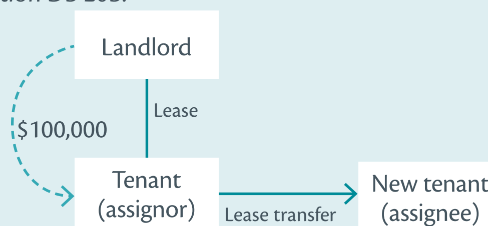
For income, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of income is allocated to an income year (the balance year) ending before the end of the spreading period, if:

- at the beginning of the balance year, the person holds the land right or the estate in land from which the land right is granted; and
- in the balance year, the person ceases to hold the land right or the estate in land from which the land right is granted (section EI 4B(4)).

Example

On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter into a 10-year lease. On 1 June 2016, the tenant transfers the lease to a new tenant. Both the landlord and the tenant have a balance date of 31 March.

The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.



The timing of income for the tenant under section EI 4B(4) is illustrated in the table below:

Income year	Tenant	
	Deduction	Income
2013–14	–	$10,000
2014–15	–	$10,000
2015–16	–	$10,000
2016–17	–	$70,000
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

The landlord continues to allocate the $100,000 deduction under the main spreading provision in section EI 4B(3).

For deductions, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of deductions is allocated to an income year (the balance year) ending before the end of the spreading period if:

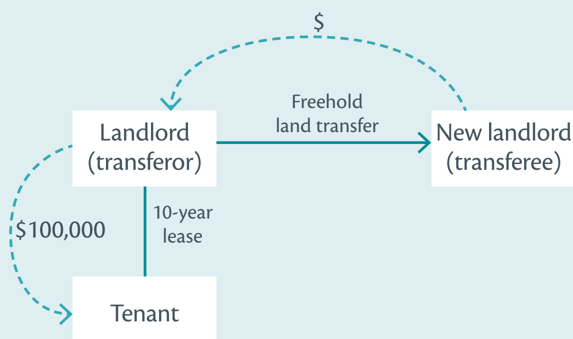
- at the beginning of the balance year, either or both the land right and the estate in land from which the land right is granted are held by the person or an associated person; and
- at the end of the balance year, neither of the land right and the estate in land from which the land right is granted are held by the person or an associated person (section EI 4B(5)).

Note that if the land right or the estate in land from which the land right is granted is transferred to an associated person, no "wash-up" calculation for deductions is allowed. The remaining amount of deductions continues to be allocated over the spreading period under section EI 4B(3). This is intended as an anti-avoidance measure to prevent the timing of deductions being accelerated by transferring the land right or the estate in land from which the land right is granted to an associated person.

The definition of "land provision" in section YA 1 has been amended so that the definition of "associated person" applying in section EI 4B is the one applicable to land provisions.

Example

On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter a 10-year lease. On 6 June 2016, the landlord sells the freehold land to an unassociated third party. Both the landlord and the tenant have a balance date of 31 March.



The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.

The timing of deductions for the landlord under section EI 4B(5) is illustrated in the table below:

Income year	Landlord	
	Deduction	Income
2013–14	$10,000	–
2014–15	$10,000	–
2015–16	$10,000	–
2016–17	$70,000	–
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

If the landlord had transferred the land to their spouse, the landlord would continue to allocate $10,000 of deductions to each income year until the 2022–23 income year.

The tenant continues to allocate the $100,000 amount of income under the main spreading provision in section EI 4B(3).

To prevent overlap, section EA 3, which relates to the timing of prepayments, has been amended to exclude any amounts subject to this timing provision.

Tax treatment of lease surrender payments

Income

New section CC 1C provides that if a person (the payee) derives an amount as a consideration for their agreement to the surrender or termination of a right (the land right) that is a leasehold estate or licence to use land, the amount is taxable to the payee.

The payee must be one of the following:

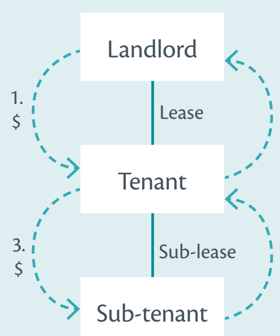
- the person who owns the estate in land from which the land right is granted; or
- the person who owns the land right.

In most cases, lease surrender payments are made by a tenant to a landlord to surrender an existing lease. However, the charging provision also applies if the payment is made by the landlord to the tenant for them to surrender an existing lease.

Example

Examples of payments that are taxable under section CC 1C include:

- a payment from a landlord (lessor) to a tenant (lessee);
- a payment from a tenant (lessee) to a landlord (lessor);
- a payment from a tenant (sub-lessor) to a sub-tenant (sub-lessee);
- a payment from a sub-tenant (sub-lessee) to a tenant (sub-lessor).



[If a person receives a lease surrender payment on behalf of another person, the existing nominee rules in section YB 21 apply to treat the amount as derived by that other person.

The term "leasehold estate" is defined broadly in section YA 1 to include any estate, however created, other than a freehold estate.[9] The charging provision, therefore, does not apply to an amount derived in relation to a freehold estate in land, such as the proceeds from the sale of land.

The reference to "amount" in section CC 1B uses the definition of "amount" in section YA 1, which includes any amount in money's worth. The charging provision therefore includes consideration that is other than cash.

Exception for a tenant or a licensee of residential premises

An exception for a tenant or a licensee of residential premises applies. The amount is not income if the payee is a natural person (an individual) and derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission.

This exclusion is intended to provide a consistent tax treatment of income and deductions for a tenant or a licensee of residential premises. An individual tenant or a licensee of residential premises is not allowed a deduction for payments of rent because they do not meet the general permission in section DA 1 and the private limitation in section DA 2(2). On the other hand, an accommodation provider, that is not a natural person (ie, they are a company), is subject to section CC 1C because they would typically be allowed a deduction for payments of rent under the general permission.

If there is a concurrent use of the land right for residential and business purposes, the amount is apportioned accordingly. The amount relating to a business purpose is taxable under section CC 1C to the extent that a tenant or a licensee whose expenditure on the premises is allowed a deduction under the general permission in section DA 1.

Deductions

New section DB 20C provides that lease surrender payments are deductible to a person (the payer) if the following conditions are met:

- the payer incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the surrender of a leasehold estate or the termination of a licence to use land;
- the payer is a person who owns the land right or a person who owns the estate in land from which the land right is granted; and
- the payee is a person who owns the estate in land from which the land right is granted, or a person who owns the land right.

Section DB 20C overrides the capital limitation in section DA 2(1). The general permission in section DA 1 must still be satisfied and the other general limitations in section DA 2 still apply.

Timing of income and deductions

No specific timing provision is provided for lease surrender payments. The timing of an amount derived or incurred under sections CC 1C and DB 20C is, therefore, determined under the general provisions of the Income Tax Act 2007.

Generally, income and deductions for lease surrender payments are allocated to the income year in which the amount is derived or incurred. This is considered appropriate for lease surrender payments as there would normally be no remaining period of the land right over which the amount can be spread at the time the lease surrender payment is derived or incurred.

[9] For income tax purposes, an interest in land has the same meaning as an estate in land.

REGISTRATION OF NON-RESIDENTS FOR GST

Sections 5(3B), 10(7A), 19(1B), 19A(1)(a)(iv), 20(3L), 20(3M), 46(1B), 51(4)(a), 51B(1)(d), 54B, 54C and 55(1B) of the Goods and Services Tax Act 1985; section 120C(1)(c) of the Tax Administration Act 1994

GST is a tax on final consumption and is intended to be neutral for businesses. Under the GST rules, a non-resident business may need to bear New Zealand GST as an economic cost of doing business. The new rules allow non-resident businesses to claim input tax deductions (and therefore refunds) in broadly the same way as a comparable New Zealand business. Allowing these deductions to be claimed has, in turn, necessitated appropriate base-maintenance measures to be introduced.

Key features

Certain non-resident businesses will be eligible to register for GST and claim input tax deductions even though they are making no taxable supplies in New Zealand. Non-resident businesses will need to satisfy certain criteria in order to be able to register under these new rules. Registration will result in the resident businesses being able to claim input tax deductions in New Zealand in a broadly comparable way to a New Zealand resident that operates a similar business. This will allow the non-resident business to access refunds of GST incurred, meaning that New Zealand GST should not generally be an economic burden on non-resident businesses.

If the non-resident business is making taxable supplies, or is part of a GST group that makes taxable supplies, it will not be able to register under the new provisions. Instead, it will register under the "regular" registration rules and be able to claim input tax deductions in accordance with those rules.

The Commissioner has special deregistration powers applicable only to non-residents registered under the new provisions. These deregistration powers, along with the other conditions of registration, are designed to encourage compliance from this non-resident group and to protect the tax base from fraudulent refund claims.

Background

As GST is intended to be neutral for businesses, it should only be an economic cost to business in carefully defined circumstances. Under the previous registration rules, non-resident businesses found it difficult to access refunds for GST incurred—particularly on services received in New Zealand.

The new rules are designed to ensure that qualifying non-resident businesses are able to reduce the economic burden of GST by registering and claiming refunds in appropriate instances.

Detailed analysis

Registration

Section 54B sets out the registration criteria for non-residents. The Commissioner may register a non-resident if satisfied that:

- The person is registered for a consumption tax in the territory in which they are resident. Or, if that territory does not have a consumption tax (or one that applies to the activities of the person), it must have a taxable activity that would make them liable to be registered in New Zealand if they were operating here. At present, this means that the person must be making supplies (on an annual worldwide basis) greater than $60,000.

  This criterion is largely directed at ensuring that the non-resident is a genuine business. The rules accept registration for a comparable tax in another jurisdiction as a proxy for the legitimacy of a business. In doing so, the rules recognise that some countries do not have consumption taxes, or have taxes with a narrower base than New Zealand's GST. In order to accommodate those businesses, while still requiring some evidence of the "genuineness" of an operation, the $60,000 a year supply test applies.
- The person's input claim for their first registration period is likely to be greater than $500. Registering and administering non-resident businesses involves administration costs for Inland Revenue. Having a minimum claim amount ensures that only businesses that incur a reasonable degree of expenditure in New Zealand can register. This prevents processing GST returns when the administration costs involved would outweigh any refund provided.
- The person's business does not involve the on-selling of services when it is reasonably foreseeable that those services will be received in New Zealand by a non-registered person. This criterion is intended to prevent any fraud risk, which would involve people in New Zealand receiving "pooled" services through a non-resident entity. For example, a group of New Zealand students could establish and register for GST an "education services" company in another country. That company agrees to pay the fees and living costs of the students in return for the students paying it for its services. The non-resident company could not register in New Zealand and claim New Zealand input tax on fees because it is reasonably foreseeable that it will be supplying education services that are received in New Zealand by non-resident students.

NEW LEGISLATION

- The person is not carrying on, or intending to carry on a taxable activity in New Zealand and is not, or intending to become a member of a group of companies carrying on a taxable activity in New Zealand. It is important to note that a non-resident that plans on carrying out a taxable activity in New Zealand (or being part of a group that does) is not precluded from registering from GST. Instead, they should register under the "regular" rules and claim input deductions accordingly. The effect of this rule is that only a non-resident that makes no taxable supplies in New Zealand (or, in other words, is not obliged to return any output tax) is able to register under section 54B of the GST Act.

If, sometime after registration, a person starts making taxable supplies, or joins a group that makes taxable supplies, their registration status changes from someone being registered under section 54B to someone registered under the "regular" rules from the date they start making taxable supplies or join the group, as applicable (see section 54B(2)).

A specific timing rule has been included in section 54B(3). Under this rule, the date at which a person either ceases to be eligible to be registered under section 54B, or becomes registered under that section, is the end of a taxable period. This ensures that there are no taxable periods when a person has to complete a return that incorporates two sets of rules.

Effect of registration

Input tax deductions

A non-resident business that is registered under section 54B will generally claim input tax deductions under section 20(3L). This section allows input tax to be deducted to the extent to which goods or services are used for, or available for use in making taxable supplies, treating all supplies made by the person as if they were made and received in New Zealand.

The requirement that the supplies must be treated as being made and received in New Zealand is to avoid a person claiming input deductions on what would be exempt supplies on the basis that it may export (and therefore zero-rate) those supplies. This would provide a mechanism for turning exempt supplies into taxable supplies and artificially inflate the input tax deductions the non-resident could claim.

This test effectively asks the registered person to work out what would be their input tax deductions if they were a solely New Zealand business. It is accepted that this will require some knowledge of New Zealand GST. However, given the broad GST base, it is expected that most businesses that operate outside of the financial services and residential housing sectors will be eligible to deduct nearly all of their input tax.

Section 20(3M) provides a further option for claiming input deductions for non-resident businesses that principally make supplies of financial services. If they choose, they can agree with the Commissioner a fair and reasonable method of apportioning input tax claims. This provision effectively mirrors section 20(3E), which allows New Zealand financial services providers to reach similar agreements with the Commissioner.

Accounting basis

Section 19(1B) provides that when the Commissioner registers a non-resident under section 54B, that person must account for GST on a payments basis. This is a base-protection measure to ensure that refunds are not provided when the GST has not been incurred. It will require the non-resident to actually pay an amount in order to claim input tax in relation to that amount. A consequential amendment has also made to section 19A(1)(a) to effect this.

Taxable periods

No special rules are being introduced in relation to filing periods for non-residents. The normal rules will apply to determine whether they should file GST returns on a monthly, two-monthly or six-monthly basis.

Right to withhold refunds

Generally, the Commissioner has 15 working days to refund an amount of input tax in accordance with a return. This can be extended if the Commissioner, within those 15 working days, notifies the person that she intends to investigate the return. For registered non-residents, section 46(1B) has been added to extend this refund and investigation period to 90 days. This extended period reflects the fact that returns from non-residents may involve some communication before they can be finally processed. To allow for this communication (including matters such as unfamiliarity with the non-resident business or potential language barriers), an extended period is desirable.

A separate amendment to section 120C(1) of the Tax Administration Act 1994 switches off use-of-money interest accruing in the event that the Commissioner extends the refund period beyond the original 90 days.

Groups of companies

New section 55(1B) clarifies that a non-resident registered under section 54B cannot join a group if it would result in the group having both resident and non-resident members. This ties in with section 54B(2), discussed above. In the event that a person registered under section 54B does join such a group, their registration status will revert to "normal" at that time.

It is anticipated that a non-resident company registered under section 54B should be able to group with other companies also registered under that section.

Cancellation of registration

Under section 54C, there are instances when the Commissioner can, in addition to powers that already existed under sections 52(5) and (5A), cancel the registration of a non-resident registered under section 54B. These situations are:

- When the Commissioner is satisfied that the person is no longer eligible to be registered under section 54B(1)(a). This means that if the person's registration for consumption tax in their home jurisdiction lapses, or if their supplies drop below $60,000 a year (and their home jurisdiction does not have a consumption tax that applies to them), they can be deregistered in New Zealand. The rule is intended to ensure that if a person, for example, artificially inflates their turnover to register for GST in New Zealand but is or becomes effectively a shell company, they can be deregistered. This is consistent with the idea that only genuine non-resident businesses should be eligible to register for GST.
- When the person, for three consecutive taxable periods, has either not filed a return or has filed a late return. This rule is intended to encourage compliance in non-residents. It is expected that a non-resident may have periods when their involvement with New Zealand is limited or non-existent. Rather than letting registration continue indefinitely, this rule should encourage them either to file nil-returns for those periods or make the conscious decision to deregister.

A failure to file, or filing late, for three consecutive periods will result in deregistration and a prohibition on re-registering for five years. That prohibition also applies to non-resident associates of the person. This will prevent a non-resident group registering one company and, if that company is deregistered, then registering another member of the group in its place. If a person's registration is cancelled under this section, the effective date of the cancellation is the first day of the third period.

A consequential amendment to the deregistration provision in section 52(7) has been made so that it only applies to non-residents that are not registered under section 54B. This change is necessary because, without it, any person registered under section 54B would arguably be at risk of being deregistered under section 52(7).

Section 5(3B) has also been included to clarify the effect of deregistration of non-residents. Under section 5(3), there is a risk that a non-resident that deregistered for any reason may be liable for output tax on the market value of all of their business assets—even if those assets were offshore. This would result in over-taxation of assets that had no connection with New Zealand. Under section 5(3B) the only deemed supplies that would occur on deregistration would be:

- goods present in New Zealand at a time immediately before the person ceases to be registered; and
- services that would be performed in New Zealand at that time the person ceases to be registered.

A consequential amendment has been made to section 10(7A) to ensure that the value of these deemed supplies is their open market value.

Application date

The amendments all apply from 1 April 2014.

TOOLING COSTS

Section 11(1)(p) of the Goods and Services Tax Act 1985

Under the previous rules, manufacturing tools that were separately charged to a non-resident, usually could not be zero-rated (because they never left New Zealand). This was so even if they were only used to manufacture exported goods, with no actual consumption occurring in New Zealand. This result was contrary to the general "destination principle" in the GST rules which states that only domestic consumption should be subject to GST.

Background

A new section 11(1)(p) introduces a zero-rating rule that applies to what are known as "tooling costs". These are costs for specialised tools that a New Zealand resident manufacturer charges to a non-resident purchaser. International practice dictates that these tooling costs are charged separately to ensure that the purchaser retains title to the tools necessary to fulfil their order. This practice is designed to stop a manufacturer using tools to create counterfeit goods once an initial contract has been fulfilled. It is not usually intended that the purchaser will take delivery of the tools, so they generally remain in New Zealand.

The tools are only used to make exported products that are themselves zero-rated. However, because the tools are not exported, manufacturers are required to charge GST on any tooling component of an order.

Key features

Under section 11(1)(p), goods are zero-rated if they are tools used solely to manufacture goods that will be for export from New Zealand and are supplied to a non-resident that is not a registered person. This means that, if the goods being manufactured are in part for the domestic market, they will not qualify for zero-rating. Equally, if the non-resident is registered, the goods will be standard-rated, in the expectation that the registered recipient will be able to claim any GST charged as an input tax deduction.

The wording of this provision is consistent with corresponding provisions in Australia and Europe, and is designed to align New Zealand with international standards.

Application date

The amendment applies from 1 April 2014.

TAX CONCESSIONS FOR CERTAIN NON-RESIDENT COMPANIES

Sections LZ 2 to LZ 5, and "non-resident investment company" and "development investments" in section YA 1 of the Income Tax Act 2007; Income Tax (Non-resident Investment Companies) Order 1970; Income Tax (Non-resident Investment Companies) Order 1972; Income Tax (Non-resident Investment Companies) Order (No 2) 1972; Income Tax (Non-resident Investment Companies) Order (No 3) 1974

The residual tax concessions for certain non-resident investment companies in the Income Tax Act 2007 have been repealed as they have outlived their original purpose and are inconsistent with New Zealand's broad-base, low-rate tax system. Moreover, retaining the tax concessions posed a revenue risk.

Background

The Income Tax Act 2007 provided residual tax concessions for certain non-resident companies investing in projects specified in four Orders in Council. The main concession related to interest derived by these non-resident investment companies from specified projects.

The income tax on interest derived by a non-resident investment company from a specified project was limited to the lower of the New Zealand company tax rate and the tax rate imposed in the non-resident company's home country. This was done by providing a tax credit for the amount (if any) by which the New Zealand company tax exceeded the amount of home tax. A similar concession applied for dividends derived by a non-resident investment company from specified projects. The interest paid to the non-resident investment company from these specified projects was also exempt from non-resident withholding tax.

The tax concessions for non-resident investment companies were generally repealed in 1995 as they were considered inconsistent with a broad-base, low-rate tax system, and were considered to be largely redundant in light of international tax reforms at that time. However, the concessionary rules were grandparented for the four Orders in Council then in force. The Orders in Council were:

- Income Tax (Non-resident Investment Companies) Order 1970;
- Income Tax (Non-resident Investment Companies) Order 1972;
- Income Tax (Non-resident Investment Companies) Order (No 2) 1972; and
- Income Tax (Non-resident Investment Companies) Order (No 3) 1974.

Key features

The residual tax concessions for certain non-resident investment companies in the Income Tax Act 2007 have been repealed, and related Orders in Council also revoked. The concessions outlived their original purpose and are inconsistent with a broad-base, low-rate tax framework.

Application date

The amendments apply from the 2013–14 income year.

PROVISIONS RELATING TO OVERSEAS BENEFITS

Sections CW 28, MB 1, "New Zealand superannuation", "New Zealand superannuitant", and "veteran's pension" in section YA 1 of the Income Tax Act 2007 and section 70 of the Social Security Act 1964

Some provisions relating to overseas social security-type benefits and pensions (overseas benefits) in the Income Tax Act 2007 have been rationalised to simplify and update them in line with other legislative changes.

Background

Under section 70 of the Social Security Act 1964, a person's entitlement to a New Zealand benefit is reduced if the person is entitled to, or receives an overseas benefit that is of a similar nature to the New Zealand benefit. This is referred to as the "direct deduction policy". Under this policy, a person's entitlement to a New Zealand benefit is reduced directly on a dollar-for-dollar basis by the amount of the overseas benefit.

The rationale for this direct deduction policy is to ensure that all New Zealand pensioners and beneficiaries receive an equitable level of social security-type benefits, regardless of whether this amount is fully funded by New Zealand or is a combined amount of New Zealand and overseas government-provided benefits.

New Zealand benefits covered by section 70 include New Zealand Superannuation, the veteran's pension and income-tested benefits (such as Jobseeker Support or Sole Parent Support).

Section CW 28(1)(e) of the Income Tax Act 2007 exempts certain overseas benefits from income tax to the extent that the direct deduction policy in section 70 of the Social Security Act 1964 applies.

The interaction between the Income Tax Act 2007 and the Social Security Act 1964 was considered complex. Some provisions also needed updating to reflect other legislative changes.

Key features

The amendments rationalise some provisions relating to overseas benefits in the Income Tax Act 2007 so that these provisions are simplified, particularly the interaction with the Social Security Act 1964. The amendments do not reduce any person's entitlements to New Zealand benefits or change the tax treatment of these entitlements.

Application date

The amendments apply from 17 July 2013, which is the date of enactment of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013.

Detailed analysis

Under the new rules, section CW 28(1)(e) of the Income Tax Act 2007 exempts from income tax certain overseas benefits to the extent that section 70 of the Social Security Act 1964 applies.

Overseas benefits subject to direct deduction

Under the new rules, section CW 28(2)(a) of the Income Tax Act 2007 exempts from income tax an overseas benefit that is subject to the direct deduction policy in section 70(1) of the Social Security Act 1964 to the extent that the overseas benefit reduces:

- a New Zealand monetary benefit paid under the SSA; or
- a New Zealand monetary benefit, other than New Zealand Superannuation or a veteran's pension, paid under the Social Welfare (Transitional Provisions) Act 1990.

The tax exemption is intended to equalise the amount a person entitled to a New Zealand benefit receives in their hand irrespective of whether or not they also receive an overseas benefit. The tax exemption is necessary because the rates of New Zealand monetary benefits paid under the Social Security Act 1964, which excludes New Zealand Superannuation and the veterans' pensions, are set in legislation at the net rate and grossed-up for income tax purposes.[10] The direct deduction policy therefore reduces the net rate of the New Zealand benefit by a dollar for every gross dollar amount of overseas benefit received.

Note that this exemption does not apply to overseas pensions that are of a similar nature to New Zealand Superannuation and a veteran's pension. The New Zealand monetary benefits paid under the Social Security Act 1964 exclude New Zealand Superannuation and the veteran's pension.[11] A person who receives an overseas pension that has an effect of reducing New Zealand Superannuation or a veteran's pension is taxed on the overseas pension amount. This is because the rate of New Zealand Superannuation or the veteran's pension is set in legislation as a gross rate, so the direct deduction policy is reducing the gross rate dollar-for-dollar against the gross amount of overseas benefit.

[10] Note that the amount of tax for a PAYE income payment that is an income-tested benefit payable or paid under the Social Security Act 1964 is determined by the Commissioner of Inland Revenue in consultation with the chief executive of the Ministry of Social Development. (See section RD 11(3) of the Income Tax Act 2007.)

[11] New Zealand Superannuation and the veteran's pension is paid under the New Zealand Superannuation and Retirement Income Act 2001 and the War Pensions Act 1954 respectively.

Section CW 28(2)(a)(i) of the Income Tax Act 2007 has been amended to no longer refer to monetary benefits paid under Part 1 of the Social Security Act 1964 to reflect changes to that Act. Monetary benefits have been relocated from Part 1 to other parts of the Social Security Act 1964 over the years, and again were restructured as part of the Social Security (Benefit Categories and Work Focus) Amendment Act 2013. Section CW 28(2)(a)(i) of the Income Tax Act 2007 now refers to monetary benefits under the Social Security Act 1964.

Special banking option

Under section 70(3) of the Social Security Act 1964, a special banking option is available for those who receive an overseas benefit from certain countries, namely the United Kingdom, Ireland, Jersey, Guernsey, Australia and the Netherlands.[12] The special banking option is an alternative deduction method which involves less complex administration and compliance costs around exchange rate movements.

An eligible person may elect into the special banking option to have their overseas benefit paid directly into a special bank account managed by the Ministry of Social Development (MSD). The person does not have access to the funds in this account, but in turn they receive an amount equivalent to the New Zealand benefit. Note that New Zealand benefits that can be subject to the special banking option include New Zealand Superannuation, the veteran's pension and monetary benefits paid under the Social Security Act 1964.

Under the new rules, section CW 28(2)(b) exempts from income tax overseas benefits that are subject to the special banking option arrangement. This tax exemption is intended to prevent double taxation of both the amount of overseas benefit (received by MSD in a special banking option account) and the New Zealand benefit a person receives under the special banking option from MSD. A person who receives from MSD under the special banking option an amount equivalent to the full amount of New Zealand benefit is liable to New Zealand tax on that amount. Exempting the amount of overseas benefit from income tax reflects the fact that the equivalent amount they receive from MSD has been taxed as a PAYE income payment.

The changes enacted simplify the interaction between section CW 28(2)(b) of the Income Tax Act 2007 and section 70(4) of the Social Security Act 1964—that is, to exempt the overseas benefit amount retained by the MSD. The latter part of section CW 28(2)(b) of the Income Tax Act 2007 from "but not to the extent …" and the reference to section CW 28 of the Income Tax Act 2007 in section 70(4) of the Social Security Act 1964 have been repealed.

Section 70(4) of the Social Security Act 1964 now deems the amount paid out by MSD under the special banking option as a composite benefit. Repealing the reference to section CW 28 in that section means that section 70(4) can be ignored for income tax purposes.

Family scheme income

Section MB 1(2)(a) includes the amount of overseas benefit, which is tax-exempt under section CW 28(2)(a), in a person's family scheme income, which is used to calculate entitlements to various social assistance programmes, including Working for Families tax credits. Although the amount of tax-exempt overseas benefit is not included in a person's taxable income for the calculation and payment of tax, it is available for the person's day-to-day living expenses and is received alongside a reduced amount of New Zealand benefit under section 70(1) of the Social Security Act 1964. It is therefore appropriate to still count these overseas benefit amounts for social assistance purposes.

The amount of overseas benefit subject to the special banking option, which is tax-exempt under section CW 28(2)(b), is not included in a person's family scheme income. The amount of overseas benefit subject to the special banking option is retained by MSD and it is not available for a person's day-to-day living expenses. It is therefore appropriate not to count these overseas benefits for social assistance purposes. For those who apply the special banking option, an amount equivalent to the full amount of New Zealand benefit is already included in the person's taxable income and captured for social assistance purposes under section MB 1(1) of the Income Tax Act 2007.

Updating definitions

Certain definitions in section YA 1 of the Income Tax Act 2007 have been updated.

References to section 70(3)(b) of the Social Security Act 1964 in paragraph (b)(ii) in the definition of "New Zealand superannuation" and paragraph (b) in the definition of "veteran's pension" in section YA 1 have been repealed. These references were unnecessary because people using the special banking option receive the full amount of New Zealand Superannuation and the veteran's pension under the New Zealand Superannuation and Retirement Income Tax 2001 and the War Pensions Act 1954 respectively. The removal of the reference to section CW 28 of the Income Tax Act 2007 in section 70(4) of the Social Security Act 1964 is consistent with this approach.

Also, references to the Social Welfare (Transitional Provisions) Act 1990 in paragraph (b)(iii) in the definition of "New Zealand superannuation", paragraph (b)(ii) in

[12] See regulation 6 of the Social Security (Alternative Arrangement for Overseas Pensions) Regulations 1996.

the definition of "New Zealand superannuitant", and paragraph (c) in the definition of "veteran's pension" in section YA 1 have been repealed. These references were unnecessary because most parts of the Social Welfare (Transitional Provisions) Act 1990 have been repealed.

"ASSOCIATED PERSONS" DEFINITION – POWER OF APPOINTMENT OR REMOVAL TEST

Section YB 11 of the Income Tax Act 2007

The amendment to section YB 11 of the Income Tax Act 2007 ensures that a trustee is not associated with a person who holds the power of appointment or removal of that trustee in their professional capacity.

Background

Section YB 11 treats a trustee of a trust and a person who has a power of appointment or removal of that trustee as associated persons. This section is intended to supplement the trustee-settlor associated persons test in section YB 8—that is, to treat a person who has the power to appoint or remove trustees similar to a settlor of a trust who usually retains the power.

Before the amendment, section YB 11 could include the relationship between professional advisors and their clients. This outcome was not intended as professional advisors hold any power in their professional capacity only and would typically not benefit under the trust. Also, this outcome was inconsistent with the existing exclusion of professional advisors from the definition of "settlor".[13]

Key features

Section YB 11 has been amended to ensure that a trustee is not associated with a person who holds the power of appointment or removal of that trustee in their professional capacity if the person meets all of the following criteria:

- the person holds the power as a provider of professional services;
- the person is a member of an approved organisation, as that term is defined in section 3(1) of the Tax Administration Act 1994, for such providers of professional services; and
- the person has not benefited from the trust and is not eligible to benefit from the trust.

Current approved organisations under the Tax Administration Act 1994 are the New Zealand Institute of Chartered Accountants, New Zealand Law Society, and the Society of Trust and Estate Practitioners.

Application date

The application date for this amendment is the same as the date when the current associated persons definition came into force.

The general application date for the amendment (excluding those applying for the land provisions) is the 2010–11 income year.

For the purposes of the land provisions (as defined in section YA 1) other than section CB 11 (which relates to disposal of land within 10 years of completing improvements), the amendment applies to land acquired on or after 6 October 2009.

For the purpose of section CB 11, the amendment applies to land on which improvements began on or after 6 October 2009.

[13] Currently, when a professional advisor assists in establishing a trust by settling a nominal sum on trust on behalf of someone, they are not the real settlor of the trust but are only an intermediary or facilitator. The real settlor is the person who the professional advisor acted for in making the settlement. The existing nominee rule in section YB 21 treats a person whom the professional advisors acted for as the settlor rather than the professional advisor.

"ASSOCIATED PERSONS" DEFINITION – TRIPARTITE TEST

Section YB 14 of the Income Tax Act 2007

The amendment to section YB 14 of the Income Tax Act 2007 prevents overreach of the tripartite test by treating a limited partnership as a company for the purposes of the tripartite test.

Background

The tripartite test in section YB 14 associates two persons if they are each associated with the same third person under different associated persons tests. The tripartite test acts as an important buttress to the other associated persons tests and makes the associated persons definition as a whole more difficult to circumvent.

The requirement that the two persons have to be associated with the same third person under different associated persons tests in section YB 14(1)(b) ensures that the tripartite test does not apply more widely than is necessary to protect the tax base.

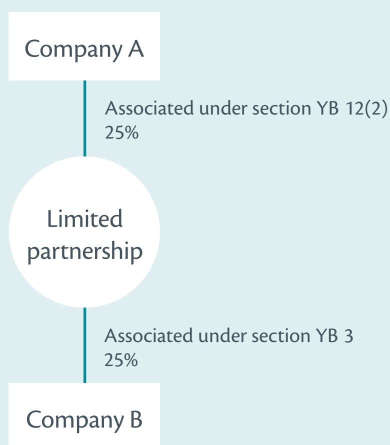
Previously, there was an overreach of the tripartite test in relation to a limited partnership.

Key features

New section YB 14(4) treats a limited partnership as a company for the purposes of applying the tripartite test in section YB 14(1). This remedial amendment is intended to prevent the overreach of the tripartite test in relation to limited partnerships.

Example 1

Company A holds 25% of a limited partnership, which holds 25% of Company B.



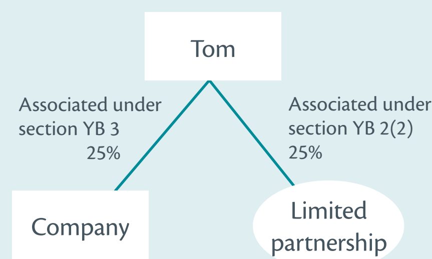
Under the associated persons definition, Company A is associated with the limited partnership under the limited partnership test in section YB 12(2). The limited partnership is associated with Company B under the company and person other than a company test in section YB 3.

Previously, the tripartite test applied to associate Company A and Company B (the limited partnership being the common third person). This was the case even though Company A only had an effective 6.25% interest in Company B (by multiplying Company A's 25% interest in the limited partnership by the limited partnership's 25% interest in Company B). Company A and Company B have no other common shareholders.

New section YB 14(4) treats a limited partnership as a company for the purposes of applying the tripartite test. As a consequence, Company A and Company B are now not associated under the tripartite test.

Example 2

Tom holds 25% of a company and 25% of a limited partnership.



Under the associated persons definitions, Tom is associated with the company under the company and person other than a company test in section YB 3. Tom is also associated with the limited partnership under the limited partnership test in section YB 12(2).

Previously, the tripartite test applied to associate the company and the limited partnership (Tom being the common third person). This was the case even though Tom, the common owner in the entities, only held a 25% interest in each entity.

The company and the limited partnership are now not associated under the tripartite test. This is because under that test, Tom is associated with the company and the limited partnership (which is treated as a company under section YB 14(4)) under the same associated persons test—the company and person other than a company test in section YB 3.

Application date

The application date for this amendment is the same as the date when the current associated persons definition came into force.

The general application date for the amendment (excluding those applying for the land provisions) is the 2010–11 income year.

For the purposes of the land provisions (as defined in section YA 1) other than section CB 11 (which relates to disposal of land within 10 years of completing improvements), the amendment applies to land acquired on or after 6 October 2009.

For the purpose of section CB 11, the amendment applies to land on which improvements began on or after 6 October 2009.

LIMITED TAX EXEMPTION FOR CHILDREN

Section CW 55BB of the Income Tax Act 2007

The amendment to section CW 55BB of the Income Tax Act 2007 corrects an error to reflect the original policy intent of the limited tax exemption for children.

Background

As part of Budget 2012, a limited tax exemption for children replaced an out-dated tax credit for the active income of children.

Section CW 55BB tax-exempts a school child from up to $2,340 of income if that income is not taxed at source; such as money for babysitting or mowing the neighbour's lawns. The limited tax exemption does not apply to the following situations:

- when the income is subject to withholding tax such as salary or wages, or interest; or
- when the child earns more than $2,340 of income that is not taxed at source.

Before the amendment, income from casual domestic work that is not taxed at source was not exempt. The "PAYE income payment" definition, which is used in section CW 55BB to identify income that is not tax-exempt did not cover income from casual domestic work.[14] It meant that a child who earned income from their casual domestic work (such as babysitting or mowing lawns) may not have received the benefit of the exemption. This was inconsistent with the policy of introducing the limited tax exemption.

Key features

To correct this error, the "PAYE income payment" exclusion in section CW 55BB(2)(a)(i) has been amended to refer to an amount of PAYE income payment from which the person's employer is required to withhold tax under the PAYE rules. This ensures that casual domestic work of a child is tax-exempt.

Application date

The amendment applies from the 2012–13 tax year, which is the date when the limited tax exemption for children came into force.

[14] See section RD 16 and the definition of "private domestic worker" in section YA 1 of the Income Tax Act 2007.

DEDUCTIBILITY OF DEPRECIABLE INTANGIBLE PROPERTY LISTED IN SCHEDULE 14

Section EE 7 of the Income Tax Act 2007; section EE 7 of the Income Tax Act 2004

The amendments clarify that depreciable intangible property listed in schedule 14 of the Income Tax Act 2007 and in schedule 17 of the Income Tax Act 2004 is deductible under the depreciation rules.

Background

Previously, there had been some uncertainty over whether certain depreciable intangible property listed in schedule 14 of the 2007 Act and schedule 17 of the 2004 Act was deductible under the depreciation rules. This was a result of changes to the tax legislation dating from 1993, when certain intangible property such as "the right to use land" became deductible under the depreciation rules.

In particular, the uncertainty arose from the exclusion of excepted financial arrangements from the definition of "depreciable property" in section EE 7(e) under the 2007 and the 2004 Income Tax Acts. The exclusion was introduced by the 2004 Act.

Leases are excepted financial arrangements under section EW 5(9) of the 2007 and the 2004 Income Tax Acts and the term "lease" is widely defined in the financial arrangements rules to include leases or licences of land, and licences to use intangible property. Consequentially, most depreciable intangible property listed in schedules 14 and 17 of the 2007 and 2004 Income Tax Acts (respectively) would be excepted financial arrangements and could be excluded from being depreciable property for deduction purposes.

Also, the specific exclusion of land from the definition of "depreciable property" in section EE 7(a) of the 2007 Income Tax Act created uncertainty over whether the "right to use land" listed in schedule 14 was deductible under the depreciation rules. This was a result of adopting a generic definition of "land", which includes leases and licences of land, as part of the rewrite of the Income Tax Act 2004.

Key features

The exclusions for land and excepted financial arrangements from the definition of "depreciable property" in section EE 7 have been amended. The purpose is to clarify that depreciable intangible property listed in schedule 14 of the 2007 Income Tax Act and schedule 17 of the 2004 Income Tax Act remains depreciable for deduction purposes.

Application dates

The amendment to section EE 7 of the Income Tax Act 2007 applies from 1 April 2008.

The amendment to section EE 7 of the Income Tax Act 2004 applies from 1 April 2005.

KIWISAVER AND VOLUNTARY BONDING SCHEMES

Section 4 of the KiwiSaver Act 2006

The KiwiSaver Act 2006 has been amended so that no employee deductions can be made, and no compulsory employer contributions are required, in respect of Voluntary Bonding Scheme payments made to KiwiSaver members.

Background

Voluntary Bonding Schemes are operated by the Ministry for Primary Industries, the Ministry of Health, or the Ministry of Education. The schemes provide payments to encourage recently graduated teachers, doctors, nurses, midwives and vets to apply to work in hard-to-staff specialities or locations. Voluntary Bonding Scheme payments are payable after three years and increase with the number of years worked (up to five years). They were set up in 2009, with the first payments beginning in 2012.

The after-tax amount of the Voluntary Bonding Scheme payment is put towards repayment of any remaining student loan debt. If there is no remaining student loan, the after-tax amount is paid directly to the applicant.

Key features

The amendment ensures that no employee deductions are made in respect of Voluntary Bonding Scheme payments made to KiwiSaver members. It also means that no compulsory employer contributions are required.

Application date

The amendment applies from 17 July 2013.

EXCEPTED FINANCIAL ARRANGEMENTS

Sections ED 4 and EW 8 of the Income Tax Act 2007

Changes have been made to the treatment of certain excepted financial arrangements under the financial arrangements rules. The changes ensure that the legislation conforms more closely to the policy intent of reducing compliance costs for taxpayers and removes the previous rule's potential "overreach".

Background

The previous election rule allowed a taxpayer to elect to treat five categories of excepted financial arrangements as financial arrangements. These five types of excepted financial arrangements are contained in subsections EW 5(21)–(22):

- agreements for the sale and purchase of property or services where all of a party's sales or purchases are prepaid and the total value of prepayments is $50,000 or less;
- short term agreements for sale and purchase;
- short-term options;
- travellers' cheques; and
- variable principal debt instruments, if the total value of such instruments is $50,000 or less.

The policy rationale for allowing taxpayers to elect to treat these excepted financial arrangements as financial arrangements under section EW 8 was to reduce compliance costs, particularly in the context of trade payables and receivables denominated in foreign currency in the ordinary course of a taxpayer's business. Ordinarily, the tax rules value these at the spot rate applicable at the date of sale or purchase, whereas accounting rules for financial statements value these at the spot rate applicable at balance date. Therefore, the ability to elect to treat trade payables and receivables denominated in a foreign currency (being excepted financial arrangements) as financial arrangements meant that taxpayers could use the value reported in financial statements for tax purposes.

However, the issue is that the election rule had the unintended consequence of allowing taxpayers to obtain a deduction for the purchase price of acquiring a short-term agreement for sale and purchase (being an excepted financial arrangement) by applying the financial arrangements rules. Outside of the financial arrangements rules, an amount paid to purchase a short-term agreement for sale and purchase would ordinarily be on capital account.

Key features

Section EW 8 has been amended so that only certain short-term agreements can be elected to be treated as financial arrangements. These are short-term agreements acquired in the course of a business of purchasing or having assigned to them short-term agreements with debts outstanding, for the purpose of collecting the debts outstanding. For example, it will apply to a debt collection agency acquiring overdue telephone accounts in order to collect the debts owing without recourse to the seller of the debts. It will also apply to debt factoring where the factor acquires the debts without recourse to the seller of the debts.

In addition, new section ED 4 provides that when a taxpayer has one of the five excepted financial arrangements listed above, denominated in a foreign currency, they may choose to value any debts outstanding under the excepted financial arrangement at the same spot exchange rate they use in preparing financial statements. The intention behind this new section is to minimise compliance costs for taxpayers.

Detailed analysis

The issue of the potential "overreach" of section EW 8 has been addressed by limiting the ability to elect to treat excepted financial arrangements as financial arrangements to short-term agreements for sale and purchase that are acquired in the course of a debt-collecting business.

In addition, the original policy rationale underlying section EW 8 of reducing compliance costs is achieved by introducing new section ED 4. Section ED 4 allows taxpayers with trade receivables or trade payables denominated in a foreign currency (that is, excepted financial arrangements), and who determine foreign exchange values at balance date for amounts outstanding in their financial statements, to use this balance date foreign exchange value for tax purposes.

The rule is optional but once a taxpayer elects into the rule for an excepted financial arrangement, they must continue to apply the rule to all of their excepted financial arrangements that are of the same type. A taxpayer's decision to elect into the rule will be reflected in the tax position they take in their return of income for the income year. No prior notice of election is required.

Application date

The amendments apply to tax returns filed on or after 27 September 2012, being the date that the changes were announced. They do not apply to taxpayers who have taken a tax position or obtained a binding ruling or determination for an excepted financial arrangement before 27 September 2012.

TIME PERIOD FOR REFUNDS UNDER THE INCOME TAX ACT 2007

Sections CD 40, CD 41, OB 71, OB 72, OB 72B, OP 6, RM 2, RM 10, RM 13, RM 17, RM 22, RM 23, RM 26, RM 28 and RM 33 of the Income Tax Act 2007; sections 41A, 125, 138E and 184 of the Tax Administration Act 1994; section 202 of the Student Loan Scheme Act 2011 and section 86L of the Stamp and Cheque Duties Act 1971

An amendment has been made to reduce the time period when refunds can be claimed under the Income Tax Act 2007 to four years from the year of assessment.

Background

If too much tax has been paid, the excess amount is refundable to the taxpayer. Over the years, the time periods for requesting refunds under the Income Tax Act have varied from between three and eight years.

The refund period was aligned with the time bar (four years) in 1944. At the time, it was considered that the time period for a taxpayer to claim a refund should be aligned with the time period for the Commissioner to amend an assessment. With the introduction of PAYE in 1957, the refund period was increased to six years in recognition of the possibility that employers could make mistakes in their calculations. It was increased to eight years in 1968. In 2004, the refund period was amended to four years from the date of assessment, with an eight-year period applying when the overpayment resulted from a clear mistake or simple oversight.

The longer periods for refunds were established in an era when the administrative environment was based on assessments carried out by the Commissioner. Departing from four years for a refund was aimed at ensuring taxpayers were not unduly prejudiced by any errors made by employers or the Commissioner when the PAYE scheme was introduced (as systems were not then computerised).

The time limits on refunds of tax paid in excess, and on the Commissioner amending assessments when insufficient tax has been paid, are a trade-off between achieving finality and ensuring the correct amount of tax has been paid.

In a modern tax administration environment an eight-year refund period was not consistent with the policy objective of reaching a balance between the finalising of a taxpayer's tax position at the earliest practicable stage and the accuracy of that position.

The time limit on the Commissioner to increase an assessment of tax is generally four years from the year of assessment. The Commissioner requires a period in which to determine the accuracy of taxpayer assessments. Setting the time period for refunds at four years has aligned the time period for taxpayers requesting refunds with the time period for the Commissioner increasing an assessment.

This approach also means that taxpayers requesting refunds will be treated similarly. The refund period for taxpayers who are personal tax summary taxpayers is four years. Now all taxpayers will have a refund period of four years from the year of assessment.

The new refund period is similar to that in other jurisdictions, for example, the time period in the United States is three years, and in the United Kingdom, Ireland and Australia it is generally four years.

During the Select Committee process, one of the submissions set out an example where a taxpayer returned income early in year 1—the income should have been returned in year 3. When Inland Revenue audited the taxpayer in year 7 the assessment for year 3 was amended but a corresponding adjustment was not made to the year 1 assessment, resulting in the taxpayer being taxed twice on the same income.

Officials consider that such an outcome would not be consistent with the Commissioner's duty under section 6 of the Tax Administration Act to maintain the integrity of the tax system. In such a case it would be generally appropriate not to amend the assessment to prevent double taxation of the same amount of income, and therefore minimise associated compliance and administration costs.

The Commissioner has issued an internal instruction to this effect.

Key features

The Income Tax Act 2007 has been amended to reduce the time period for refunds under the Act to four years from the year of assessment. This time period will apply consistently to all refunds.

For the donations tax credit which is refunded separately from the income tax process, the time period for taxpayers requesting refunds is four years from the end of the tax year in which the donation was made.

The time period can be extended to a maximum of six years if the Commissioner exercises her discretion under section 78B of the Tax Administration Act 1994 to allow a longer period when a taxpayer has a tax credit under section LJ 2 (tax credits for foreign income tax) or section LK 1 (tax credits relating to attributed CFC income).

The time period for refunds under the Stamp and Cheque Duties Act 1971 has also been limited to four years.

Application dates

For refunds claimed under the Income Tax Act 2007 the amendment applies to refunds for a taxpayer's 2013–14 or later tax year. This means that the current refund time periods continue to apply to refunds for a person's 2012–13 or earlier tax year.

The time period for requesting refunds for the donations tax credit will become four years from the end of the tax year in which the donation was made. This change applies to donation tax credit claims in the 2014–15 and later tax years.

FAIR DIVIDEND RATE FOREIGN CURRENCY HEDGES

Sections CV 18, DV 25, EM 1 to 8 and YA 1 of the Income Tax Act 2007

There can be a mismatch in the tax treatment of foreign currency hedges and certain offshore assets—those that are taxed under the fair dividend rate (FDR) rules and certain ASX-listed shares. This mismatch can make it more difficult to effectively hedge investments in certain offshore assets.

To address the mismatch, the new legislation provides an optional rule that effectively allows eligible taxpayers to apply FDR to their foreign currency hedges rather than the financial arrangement rules. The new rule is designed to, as much as possible, eliminate the tax mismatch.

To ensure the new rule is robust, there are restrictions on when it can be applied to ensure it is used as intended.

Background

Under the FDR rules, changes in an asset's value are not taxed. Instead, FDR assets are generally taxed on an imputed return of 5%. Conversely, changes in a hedge's value are fully taxed under the financial arrangement (FA) rules. This mismatch in treatment means that a hedge that is effective in removing the impact of unexpected currency fluctuations before tax ceases to be effective after tax.

To illustrate, say a person has an offshore asset portfolio worth US$10,000 and the NZD/USD exchange rate unexpectedly rises from $0.75 to $0.80. The person's asset portfolio is taxed under the FDR rules. In New Zealand dollars, the portfolio's value falls from NZ$13,333 to NZ$12,500 (rounded to nearest dollar). If the person had used a foreign currency hedge to completely remove the exchange rate risk, before tax is taken into account, the hedge will increase in value by NZ$833, exactly cancelling the change in their portfolio's value. The hedge is totally effective before tax.

The story is different after tax. The offshore assets have lost NZ$833 of value. However, under the FDR rules, no deduction is given for this decrease. Despite this, the $833 increase in the hedge's value is taxable. After tax, the person has lost NZ$833 from their asset portfolio but gained only NZ$600 from their hedge; the shortfall of $233 is created by the tax payment.

The mismatch does not arise with all types of foreign currency-denominated investments. Many assets denominated in foreign currencies are taxed on the same or similar basis to foreign currency hedges. This underpins why the new rule applies only in relation to certain assets.

Key features

New subpart EM provides for a new tax calculation method for certain foreign currency hedges entered into for assets taxed under FDR or ASX-listed shares that are not subject to the foreign investment fund (FIF) rules, provided the sale of those shares would not be taxable.

The new rule is optional. Eligible taxpayers can elect what hedges it applies to, and to what extent it applies for each hedge (subject to thresholds) to ensure the use of the new rule is appropriate).

The new rule only applies to widely held entities to help ensure it is used only as intended. These entities generally have muted incentives to take aggressive tax positions, have investment mandates and other documentation that disclose investment strategies.

Detailed analysis

New calculation for income or deductions from a hedge

New section EM 6 is the core of the new rule. It provides that an eligible taxpayer who has elected to use the new rule has income or an expense of:

$$\frac{\text{FDR portions value} \times 0.05 \times \text{valuation period}}{\text{days in the year}}$$

FDR portions value is the current market value of a taxpayer's hedges to the extent that the taxpayer has elected for this rule to apply to those hedges.

Valuation period is how often a taxpayer values their offshore assets (for example, each day, each week, each month). This period must be shorter than the term of the hedges a taxpayer enters into, to ensure the calculation is carried out at least once per hedge entered into.

This section therefore aligns the tax treatment of FDR assets (and some ASX-listed shares) with hedges of those assets for eligible taxpayers that have elected to use this new rule. Both assets and hedges will be taxed at approximately the same rate and with a common valuation period.

New sections CV 18 and DV 25 provide that the income or expense calculated using the above formula is taxable or deductible (as applicable). Note that section DV 25 does not override the general permission; any deemed expense that arises under section EM 6 must be related to a taxpayer's business in order for it to be deductible. The capital limitation is overridden to ensure that a negative result of the above formula arising due to eligible ASX-listed shares held on capital account is still deductible.

Financial arrangement rules will not apply

New section EM 1(3) provides that the financial arrangement rules do not apply to a hedge to the extent a taxpayer has elected for this new rule to apply (that is, its *fair dividend rate hedge portion*). Tax on the hedge is calculated solely under subpart EM.

The financial arrangement rules apply as usual to the remainder of the hedge.

Eligible assets

The new tax calculation method is available in relation to hedges used to hedge:

- assets that are taxed under the FDR method; and
- shares listed on the ASX exchange which are not subject to the FIF rules, provided the sale of those shares would be exempt under section CX 55 or would be a capital receipt as the shares are held on capital account.

The purpose of the new rule is to align the tax treatment of foreign currency hedges with the assets those hedges are entered into for. This mismatch is most significant for hedges entered into for the asset types listed above. For other assets the mismatch is either much less pronounced or does not exist, so the current treatment is more appropriate.

Eligible entities

The new rule for taxing hedges is designed to apply only to widely held investment funds and other similar entities. This restriction is intended to help ensure the new rule will be used only as intended. Widely held funds generally have muted incentives to take aggressive tax positions and have investment mandates and other documentation that disclose investment strategies.

This restriction is provided by new section EM 2, which largely mimics the widely held entity criteria in the Portfolio Investment Entity (PIE) rules (sections HM 14 and HM 15, together with the exemptions in sections HM 21 and HM 22 of the Income Tax Act 2007).

Eligible hedges and hedge portions

The new rule can only be used in relation to genuine foreign currency hedges—financial arrangements that are entered into with the sole purpose of offsetting exposure to foreign currency exchange movements in the value of their assets.

To reflect this, new section EM 3 provides the criteria for an eligible hedge. For example, a hedge must not be entered into with an associated person and, when it is first entered into, must have a fair value of zero.

An eligible hedge will not automatically be subject to the new tax calculation. A taxpayer must choose this option. This choice can be made for a specific hedge on the day the hedge is entered into or can be made for all hedges entered that will be entered into in the future.

This new method of calculating tax can be applied to part or all of a hedge. Accordingly, the taxpayer's choice needs to include the portion of the hedge or hedges to be subject to the new calculation (the *fair dividend rate hedge portion* of the hedge). There are limits on this, which are described below.

There is no prescribed way for how this decision is to be made, but sufficient records must be kept in order to satisfy the general record-keeping requirements placed on taxpayers.

Hedges of hedges

The definition of a "hedge" for the purposes of subpart EM includes a hedge of a hedge—that is, a foreign currency hedge that effectively cancels out another foreign currency hedge. This can be used to close out a hedge early.

The rules requiring an election for subpart EM to apply, as well as the limits on maximum *fair dividend rate hedge portions*, apply to hedges of a hedge in the same way as they apply to a hedge.

Maximum fair dividend rate hedge portions

The intention of the new rule is that it should only apply to hedges entered into for certain types of offshore investment—in other words, those assets where the tax mismatch is most significant. It is appropriate that hedges entered into for other types of offshore investment continue to be taxed as they are currently. Accordingly, new section EM 5 provides rules that set out the maximum *fair dividend rate hedge portion* that a taxpayer can elect.

There are two possible methods that a taxpayer can use to determine this maximum. The taxpayer is required to use the same calculation method for all of its hedges. The first method is designed to be accurate but is complicated to apply. The second method is simpler but may be less accurate. To balance this, the latter method is more restrictive.

These calculations need to be performed only on the day a hedge is first entered into. There is an additional quarterly test, described below, to ensure that a hedge's initial *fair dividend rate hedge portion* remains appropriate over time.

Method one

The first calculation method uses the formula:

$$\frac{1.05 \times (\text{eligible currency assets} + \text{proxied currency assets}) - \text{FDR hedges amount}}{\text{calculation hedge amount}}$$

Eligible currency assets refers to the eligible assets (as described above) denominated in the same currency as the hedge being entered into (the *calculation currency*).

Proxied currency assets refers to the eligible assets denominated in a different currency but the taxpayer hedges that currency with the *calculation currency*.[15] In the formula, all amounts should be expressed in the *calculation currency*.

FDR hedges amount refers to the amount of the *calculation currency* that is hedged by the taxpayer's hedges, excluding the hedge that the calculation is being carried out for (the *calculation hedge*), to the extent that they have elected for this new tax calculation method to apply (that is, each hedge's *fair dividend rate hedge portion*).

Calculation hedge amount refers to the amount of foreign currency that is hedged by the *calculation hedge*.

Example

Z has a portfolio of:

- US$20,000 worth of shares in US-based companies (eligible assets, worth NZ$40,000)
- AU$10,000 worth of shares in Australian companies (eligible assets, worth NZ$15,000)
- AU$20,000 worth of Australian bonds (non-eligible assets, worth NZ$30,000).

Z currently has two foreign currency hedges:

- A hedge for US dollars with a foreign amount hedged of $20,000 (equivalent to NZ$40,000) and a *fair dividend rate hedge portion* of 0.50.
- A hedge for Australian dollars with a foreign amount hedged of $20,000 (equivalent to NZ$30,000) and a *fair dividend rate hedge portion* of 0.25.

Z is looking to enter into a new hedge for AU$10,000. The maximum *fair dividend rate portion* for the hedge would be 0.55:

$$\frac{1.05 \times (\text{AU\$10,000} + \$0) - (\text{AU\$20,000} \times 0.25)}{\text{AU\$10,000}} = 0.55$$

Method two

The second calculation method uses two formulas. A taxpayer's maximum *fair dividend rate hedge portion* is the lesser of the two.

The first formula is:

$$1 - \frac{\text{non-eligible currency assets}}{\text{hedges amount}}$$

Unlike method one, this formula includes a taxpayer's assets regardless of the currency they are denominated in, not just the *calculation currency*. This may make it simpler for some taxpayers.

Non-eligible currency assets refers to the total value of a taxpayer's foreign assets excluding eligible assets, converted to New Zealand dollars. *Hedges amount* refers to the total amount of foreign currency that is hedged by a taxpayer's hedges, including the *calculation hedge*, again converted to New Zealand dollars. Importantly, this is *not* the amount of New Zealand dollars hedged; it is the amount of foreign currency hedged expressed in New Zealand dollars at the day's prevailing exchange rate.

The second formula is:

$$\frac{1.05 \times \text{eligible currency assets} - \text{FDR hedges amount}}{\text{current hedge amount}}$$

Eligible current assets refers to the market value of a taxpayer's eligible assets.

FDR hedges amount refers to the total amount of foreign currency that is hedged by a taxpayer's hedges *to the extent the taxpayer has elected for subpart EM to apply to that hedge*.

Current hedge amount refers to the amount of foreign currency that is hedged by the hedge currently being entered into.

All amounts in the formula should be converted to New Zealand dollars.

If the result of the first formula is less than zero, the person's maximum *fair dividend rate hedge portion* is zero.

The objective of this second method is to allocate a taxpayer's hedges to their non-eligible assets first. The rationale is that subpart EM is designed to reduce the fluctuations in the after-tax position of someone who hedges. Currency fluctuations will affect the tax position of non-eligible assets far more than it will affect the tax position of eligible assets. Allocating hedges to non-eligible assets first therefore provides the largest reductions in fluctuations in the after-tax valuation of a taxpayer's portfolio caused by currency movements.

[15] It is generally impractical to hedge every currency a fund is exposed to. Funds therefore often do what is referred to as "proxy hedging". They find correlations between the smaller currencies and larger ones (such as the USD), and hedge their exposure to the smaller currencies using the larger ones.

Example

Z from the example above decides instead to use the second method to calculate the maximum *fair dividend rate portion* for its new \$10,000 Australian dollar hedge. This hedge is equivalent to NZ\$15,000.

The value of Z's non-eligible assets (in New Zealand dollars) is \$30,000 and the value of Z's eligible assets (in New Zealand dollars) is \$55,000. Z currently has a total of \$70,000 foreign currency hedged (expressed in New Zealand dollars); after entering into this new Australian hedge its amount of total foreign currency hedged will be \$85,000.

Result of first formula

$$1 - \frac{NZ\$30{,}000}{NZ\$85{,}000} = 0.65$$

For the second formula, Z's US hedge has a *fair dividend rate portion* of 0.50 and hedges the equivalent of NZ\$40,000. Z's Australian hedge has a *fair dividend rate portion* of 0.25 and hedges the equivalent of NZ\$30,000. The item *FDR hedges amount* in the second formula is therefore NZ\$27,500 (= 0.50 × NZ\$40,000 + 0.25 × NZ\$30,000).

Result of second formula

$$\frac{1.05 \times NZ\$55{,}000 - NZ\$27{,}500}{NZ\$15{,}000} = 2.02$$

The lesser result from the two formulas is 0.65. Z's maximum *fair dividend rate portion* for its new Australian dollar hedge is therefore 0.65.

Quarterly test

The two apportionment methods described above provide appropriate initial maximum *fair dividend rate hedge portions*. The quarterly test described below ensures that, going forward, the *fair dividend rate hedge portions* for a taxpayer's hedges remain appropriate.

The formula below provides a taxpayer's *quarterly FDR hedging ratio*:

$$\frac{\text{FDR hedges amount}}{\text{eligible currency assets}}$$

FDR hedges amount refers to the total amount of foreign currency that is hedged by a taxpayer's hedges to the extent the taxpayer has elected for this tax calculation to apply to those hedges (that is, the *fair dividend rate hedge portion* of each hedge), converted to New Zealand dollars. This is not the amount of New Zealand dollars hedged but is the amount of foreign currency hedged, expressed in New Zealand dollars at the day's prevailing exchange rate.

Eligible currency assets refers to the total value of the taxpayer's eligible assets, also converted to New Zealand dollars.

If a person's quarterly *FDR hedging ratio* is greater than 1.05 they must adjust the *fair dividend rate hedge portion* to the result of the formula below:

$$\frac{0.85}{\text{quarterly FDR hedging ration}} \times \text{FDR hedge portion}$$

The effect of this formula is to bring an entity's *quarterly FDR hedging ratio* to 0.85. This adjustment must be carried out, at the latest, five working days after the end of the quarter.

If a taxpayer breaches the threshold in two consecutive quarters, it will not be able to use this new tax calculation method for currency hedges for the next two quarters.

Example

At the end of a quarter, the value of Y's portfolio is:

- US\$10,000 worth of shares in US-based companies (eligible assets, worth NZ\$20,000)
- AU\$20,000 worth of shares in Australian companies (eligible assets, worth NZ\$30,000).

Y has currently has a single foreign currency hedge: a hedge for US dollars with a foreign amount hedge of \$20,000 (equivalent to NZ\$40,000) and a *fair dividend rate hedge portion* of 0.80.

In the first formula, the *FDR hedges amount* is NZ\$32,000 (= \$40,000 × 0.80) and *eligible currency assets* is NZ\$50,000 (= \$20,000 + \$30,000). The result under the formula is 0.64:

$$\frac{NZ\$32{,}000}{NZ\$50{,}000} = 0.64$$

Y will therefore pass the quarterly test.

Next quarter the value of Y's shares fall, and they are only worth US\$5,000 and AU\$10,000 for the US and Australian shares, respectively. Assume for simplicity that exchange rates have not changed, so the US shares are now worth NZ\$10,000 and Australian shares worth NZ\$15,000.

In the formula *FDR hedges amount* remains at NZ\$32,000 but the amount of eligible currency assets has fallen to \$25,000. The result under the formula is now 1.28.

$$\frac{NZ\$32{,}000}{NZ\$25{,}000} = 1.28$$

This exceeds 1.05, so Y will have to adjust its two hedges based on the formula below. This means Y will have to change its *fair dividend rate hedge portion* on its US dollar hedge so it is 0.53.

US dollar hedge

$$\frac{0.85}{1.28} \times 0.80 = 0.53$$

Application date

The new rules apply from 17 July 2013.

TREATMENT OF EXPENDITURE FOR COMMERCIAL FIT-OUTS

Section DA 5 of the Income Tax Act 2007

The amendment ensures that capital expenditure on an item of commercial fit-out is not deductible as repairs and maintenance expenditure.

Background

Following Budget 2010, the decision was made to allow commercial building fit-out to be treated as depreciable property. This change introduced a new definition of building which conflicted with an existing, related definition. This produced an unintended policy outcome that may have allowed capital expenditure on work done to an item of commercial fit-out to be deductible as repairs and maintenance to the building. This oversight could have been exploited to claim immediate deductions for expenditure on commercial fit-out that should be capitalised and depreciated over its estimated useful life. The amendment ensures the correct outcome.

Key features

Section DA 5 provides that any capital expenditure that is incurred during work done on an item of commercial fit-out, such as the item's replacement or improvement, is not immediately deductible as expenditure on repairs and maintenance to the building.

Repairs and maintenance expenditure of a revenue nature on an item of commercial fit-out will remain immediately deductible.

Application date

The change applies for the 2011–12 and later income years. The application date is retrospective to ensure that the unintended policy outcome cannot be exploited.

GENERAL INSURANCE OUTSTANDING CLAIMS RESERVES AND EVENTS THAT OCCURRED BEFORE 1 JULY 1993

Sections CR 4(1B) and DW 4(1B) of the Income Tax Act 2007; sections CR 3(1B) and DW 3(1B) of the Income Tax Act 2004

Changes have been made to clarify the calculation of a general insurer's outstanding claim reserve when it is affected by insurance events that occurred before 1 July 1993.

Background

In 2009, changes were made to the Income Tax Act that aligned the tax treatment of an insurer's outstanding claims reserve (OCR) for general and non-life insurance, with financial reporting and actuarial practice (the 2009 changes). Movements in an insurer's OCR are deductible as the record when an insurer is reasonably expected to be liable for a claim. Following the enactment of these changes, questions were asked about how the OCR rules applied to insurance events that occurred before 1 July 1993, particularly in connection with offshore insurance business carried on by New Zealand-resident taxpayers.

Before 1 July 1993, general insurance business carried on outside New Zealand was not subject to New Zealand income tax. As a result, New Zealand insurers were unable to claim deductions in connection with any claims that were connected with that offshore business. From 1 July 1993, insurance business carried on outside New Zealand by New Zealand residents was deemed taxable. Specific transitional rules were included in the Income Tax Act 1976 to deal with the change.

The transitional rules in section DZ 10 deny insurers a deduction for any pre-1993 claims.

The 2009 changes for calculating the OCR did not specifically exclude amounts relating to pre-1993 claims and arguably tracks claims when an entitlement to a tax deduction does not exist. This outcome was not contemplated and appears to impose an unnecessary requirement on taxpayers to track insurance events for tax purposes when under the transitional rules no deduction would be allowed for a claim that is connected with a pre-July 1993 event.

Key features

New sections CR 4(1B) and DW 4(1B) clarify the interaction between the:

- rules for calculating an insurer's OCR (the 2009 changes); and
- taxation of offshore insurance business carried on by New Zealand-resident insurers before July 1993.

The section provides that claims that are subject to section DZ 10 are excluded from the calculation of an insurer's OCR.

Consequential change to the Income Tax Act 2004

Consequential changes have also been made to the Income Tax Act 2004 (sections CR 3 and DW 3) for insurers who applied the 2009 changes for earlier income years starting from 2006.

Application date

The change applies from 1 April 2008 and earlier income years.

GST AND PRIZE COMPETITIONS

Sections 2, 5(10), 9(2)(e) and 10(14) of the Goods and Services Tax Act 1985

Minor amendments have been made to the GST Act to enable cash prizes to be deducted when calculating the consideration for the supply of prize competitions.

Before 1 July 2004, when determining the consideration of a supply, organisers of prize competitions were able to deduct cash prizes from the total proceeds collected for that supply.

The wording in the GST Act which allows cash prizes to be deducted was amended, effective from 1 July 2004, to use wording contained in the Gambling Act 2003. The wording in the GST Act had previously been based on terms contained in the Gaming and Lotteries Act 1977, which the Gambling Act replaced.

The phrase which has been used in the relevant GST Act provisions since 1 July 2004 is "gambling (including a New Zealand lottery)". This is a narrower term than the collection of terms that was used before 1 July 2004, and does not include prize competitions.

Key features

Four amendments have been made to the GST Act to give "prize competitions" the same treatment afforded to gambling (including a New Zealand lottery). These amendments are:

- A definition of "prize competition" has been included in section 2 of the GST Act.
- Section 5(10) has been amended so that money paid to participate in prize competitions is treated as a payment for a supply.
- Section 10(14) has been amended so that the consideration for a prize competition will now be calculated using the following formula: *the amounts received minus any prizes (including cash prizes)*
- Section 9(2)(e) has been amended to set out that the time of supply for a prize competition is the date on which the first drawing or determination of the prize competition begins.

Detailed analysis

The GST Act does not allow deductions for cash prizes unless this is set out in a specific provision.

These amendments to the GST Act mean that cash prizes may now be deducted when determining the consideration for some amateur sporting competitions, or creative activities, which might not have fallen within the ambit of "gambling" or a "New Zealand lottery".

Application date

The amendments apply from the date of Royal assent, being 17 July 2013.

RECIPIENTS OF CHARITABLE OR OTHER PUBLIC BENEFIT GIFTS

Schedule 32 of the Income Tax Act 2007

The following organisations have been granted donee status from the 2013–14 income year:

- Fund for Timor
- OneSight New Zealand
- The Hunger Project New Zealand.

Background

New Zealand-based charities who apply some or all of their funds for overseas purposes and who want donors to receive tax benefits in connection with any donations received, are required to be named as a donee organisation on the list of recipients of charitable or other public benefit gifts in the Income Tax Act 2007.

Donee status entitles individual donors to a tax credit of 33⅓% of the amount donated to these organisations, up to the level of their taxable income. Companies and Māori Authorities are eligible for a deduction for monetary donations up to the level of their net income.

Application date

The change applies from the 2013–14 and later income years.

REWRITE REMEDIAL ITEMS

Remedial changes have been made to the Income Tax Act 2007 and the Income Tax Act 2004 on the recommendation of the Rewrite Advisory Panel. The Panel lists the submissions for a number of minor drafting matters that have been brought to the attention of the Rewrite Advisory Panel.

In general, these amendments consist of corrections of cross-references, spelling, punctuation, terminology, and consistency of drafting. The Rewrite Advisory Panel publishes lists of these maintenance items on its website, **www.rewriteadvisory.govt.nz**

Application dates

All rewrite-related amendments will apply retrospectively. In the table below, amendments to the Income Tax Act 2007 apply from the beginning of the 2008–09 income year; and Income Tax Act 2004 apply from the beginning of the 2005–06 income year.

Section of amending Act	Section of principal Act	Act	Purpose of amendment
40 157	EC 7 EC 7	ITA 2007 ITA 2004	Resolving ambiguity
47 159	EE 60 EE 51	ITA 2007 ITA 2004	Resolving ambiguity
60	HA 33	ITA 2007	Correcting a cross-reference
70	LK 1	ITA 2007	Clarifying the drafting to resolve ambiguity
86	RD 60	ITA 2007	Correcting a cross-reference
102	Schedule 3	ITA 2007	Inserting a cross-reference

REPEAL OF SECTION 2(4) OF THE TAX ADMINISTRATION ACT 1994

Section 2(4) of the Tax Administration Act 1994

Section 2(4) of the Tax Administration Act 1994 has been repealed.

Section 2(4) specified that provisions in the Tax Administration Act that corresponded to provisions in the Income Tax Act 1976 did not apply generally to any of the Inland Revenue Acts other than the Income Tax Act. This transitional provision is now redundant.

Background

Under section 2(4) of the Tax Administration Act 1994, provisions that corresponded to provisions of the Income Tax Act 1976 did not generally apply to any of the Inland Revenue Acts other than the Income Tax Acts. This provision was transitional in nature and applied because many of the sections of the Tax Administration Act 1994 originated from the Income Tax Act 1976, and such provisions applied only to income tax.

However, in 1996 the definition of "tax" in section 3(1) of the Tax Administration Act 1994 was substituted and is no longer restricted to income tax. In conjunction with the replacement of other parts of the Tax Administration Act 1994, such as disputes and penalties, with provisions that apply to all tax types, this meant that section 2(4) was spent.

Key features

Section 2(4) of the Tax Administration Act 1994 has been repealed. This means that provisions which originated in the Income Tax Act 1976 now generally apply to the Inland Revenue Acts.

Application date

The amendment applies from the date of Royal assent, being 17 July 2013.

REMEDIAL AMENDMENTS TO INLAND REVENUE'S SEARCH AND SEIZURE POWERS

Sections 16 and 16C of the Tax Administration Act 1994, Tax Administration (Form of Warrant) Regulations 2003 and the Schedule to the Search and Surveillance Act 2012

The Tax Administration Act 1994 and the Schedule to the Search and Surveillance Act 2012 have been amended to ensure that Inland Revenue's search and seizure powers are harmonised between the two Acts.

Key features

The Search and Surveillance Act codified search powers used by enforcement agencies, such as Inland Revenue. To ensure that those changes introduced by the Search and Surveillance Act 2012 to Inland Revenue's search and seizure powers in the Tax Administration Act 1994 were made consistently and to harmonise the two Acts, remedial amendments, including cross-references were inserted into the Tax Administration Act 1994.

Those provisions needed to be reflected in the Schedule to the Search and Surveillance Act 2012. Therefore, amendments have been made to both the Tax Administration Act 1994 and the Schedule to the Search and Surveillance Act 2012 to ensure that the powers are harmonised between the two Acts, as a remedial matter.

The Tax Administration (Form of Warrant) Regulations 2003 have been consequentially revoked.

All warrants under section 16(4) to access private dwellings and warrants under section 16C(2) to remove and retain documents for inspection will now be in a form prescribed by the Commissioner of Inland Revenue.

Application date

The amendments apply from 1 September 2013.

AMENDMENTS TO THE PIE RULES

Sections CB 26, DB 54, HM 12, HM 19C, HM 37, HM 60, LA 6 and YA 1 of the Income Tax Act 2007; section 31C of the Tax Administration Act 1994

Several amendments have been made to the portfolio investment entity (PIE) rules to ensure that they operate as originally intended. The amendments are largely of a technical or drafting nature.

Application dates

The amendments apply from various dates as set out below.

Key features

Disposal of certain shares by PIEs

Section CB 26

Under section CX 55, PIEs are generally not taxed on trading gains made on Australasian shares. They are, however, taxed on dividends. This creates an incentive for PIEs to sell shares just before a dividend is paid—the share price is likely to increase in anticipation of the dividend, and by selling the shares the PIE could turn a (taxable) dividend into a (non-taxable) share trading gain.

To counter this, section CB 26 provides that any gains are taxable if shares are sold after a dividend has been declared but before the dividend has been paid.

Section CB 26 has been amended so that it does not apply when the seller of the shares and the recipient of the shares are composed of the same ultimate investors (this may arise because of a restructure). This is to ensure that investors in a PIE that is restructuring are not double taxed: on the sale of shares under CB 26 (in the pre-restructure entity) and on the receipt of dividends (in the post-restructure entity).

The amendment applies from 1 April 2012.

Management fee rebates

Section HM 12

At least 90% of income derived by a PIE must be derived from specified investment types and consist of passive types of income listed in section HM 12. Section HM 12 has been amended by adding management fee rebates to the list of types of income. Management fee rebates are not active income so there are no policy concerns with PIEs deriving this type of income.

The amendment applies from 1 April 2012.

Allocation of expenses to a PIE

Section HM 37

Section HM 37 treats a multi-rate PIE's income or property in which no investor has an interest as relating to a separate investor class, in which the PIE is the sole investor. This unattributed income is taxed at 28%.

Section HM 37 has been amended to ensure that expenses that relate to the unattributed income can be allocated to this separate investor class.

There is an exception to this rule for foreign investment PIEs. For these PIEs, deductions are denied to the extent that the investments in the foreign investment PIE have been made by notified foreign investors. The policy is that expenses should not be deductible when they relate to notified foreign investors. Unattributed expenses could have been incurred for the benefit of notified foreign investors; allowing the PIE to deduct those expenses would provide a mechanism for PIEs to, in effect, deduct the expenses relating to notified foreign investors.

The amendment applies from 1 April 2012.

Changing the notified investor rate

Section HM 60

Section HM 60 has been amended to clarify that when an investor notifies an updated prescribed investor rate (PIR) to a multi-rate PIE, the PIE has the flexibility to apply this PIR from the beginning of the calculation period in which the PIE receives the notice or as soon as practicable after receipt.

The change accommodates differences in PIEs' systems and PIE return filing options, and clarifies the legislation to be in line with current practices.

In applying notified investor rates, a multi-rate PIE must use the same approach for all investors for an income year.

This amendment applies for the 2010–11 and later income years.

Refundability of PIE tax credits

Sections LA 6 and YA 1

Section LA 6 sets out the order in which any remaining refundable tax credits are used in the event that a taxpayer has any refundable tax credits remaining after satisfying their income tax liability for a tax year. Section LA 6(1) lists the types of tax credits that the section applies to.

Previously it referred to a tax credit under section LS 1 (Tax credits for multi-rate PIEs). However, previously tax credits for investors in multi-rate PIEs under sections LS 2 to LS 4 were not listed in section LA 6(1), despite them being referred to in the definition of "refundable tax credit" in section YA 1.

Section LA 6 has been amended to make it clear when PIE tax credits are refundable to investors. Tax credits under sections LS 2 to LS 4 are refundable, except to natural persons unless they are a natural person having the tax credit as a beneficiary of a trust. This restriction on refundability is to ensure that natural person investors cannot benefit by notifying a PIR that is too low.

Consequential amendments have been made to the definitions of "non-refundable tax credit" and "refundable tax credit" in section YA 1.

The amendments apply from 17 July 2013.

Notification requirements

Section 31C of the Tax Administration Act 1994

Section 31C of the Tax Administration Act 1994 requires multi-rate PIEs to provide their investors with notices setting out certain information. Section 31C has been amended to allow these notices to be provided electronically to the investor or a person authorised to act on behalf of the investor, provided that this has been consented to by the investor and, where applicable, their authorised person.

This amendment applies from 17 July 2013.

Other amendments

Other amendments to the PIE rules are:

- The heading of section DB 54, which previously read "Treatment of credits for investment fees", has been amended to read "No deductions for fees relating to interests in multi-rate PIEs". This rewording more closely reflects the content of the section.

  The amendment applies from 17 July 2013.

- Section HM 19C has been amended to correct a section reference.

  This amendment applies from 29 August 2011.

SERVICES FOR MEMBERS OF PARLIAMENT

Sections CW25 and CX11 of the Income Tax Act 2004 and sections CW31, CX12 and CX33B of the Income Tax Act 2007

Amendments have been made to correct an anomaly arising from changes to the fringe benefit tax provisions to ensure that tax is only applied to the private element of any payment or service provided to members of Parliament under the Civil List Act 1979.

Amendments in the Members of Parliament (Remuneration and Services) Bill achieve a similar outcome on a prospective basis.

Section CX33B has also been amended to clarify the administrative practice for calculating fringe benefit tax on the private element of services provided to members of Parliament.

Application dates

The amendments apply retrospectively from the application dates of the original legislation with the exception of section CX33B, which is effective from 1 July 2013.

REMOVING THE REMNANTS OF DEPRECIATION LOADING

Section DO 5 and Schedule 20 of the Income Tax Act 2007

Summary of proposed amendment

As part of Budget 2010, it was announced that depreciation loading would be removed on a prospective basis from 21 May 2010. Depreciation loading was a policy that increased the amortisation rate of most depreciable assets by 20%.

When depreciation loading was first introduced, a 20% loading was also applied to two special amortisation regimes: one that applies to certain horticultural plants and one that applies to certain land improvements made by a person involved in an agricultural business (such as a farmer). Due to an oversight, this loading was not removed from these two special regimes as part of Budget 2010.

To correct this, the Act will remove this depreciation loading from the beginning of the 2013–14 income year. Note that the amortisation rate for the regrassing and fertilising of pasture (schedule 20, part A, row 2) is not being changed as it does not have the loading.

Application date

The amendment applies from the beginning of the 2013–14 income year.

LOCAL AUTHORITIES CHANGE OF ACCOUNTING BASIS

Sections 19A(1)(a)(ii), 19AB, 19C(1), and 87 of the Goods and Services Tax Act 1985

Background

From 1 July 2013, all local authorities must account for GST on an invoice basis, rather than a payments basis. Most local authorities have accounted for GST on an invoice basis since 1 July 2001, but a small number have been allowed to continue to account on a payments basis after this date.

The most recent Order in Council, which allowed certain local authorities to account for GST on an invoice basis, expired on 30 June 2013 and has not been renewed.

Key features

New section 87 has been added to the Goods and Services Tax Act 1985 (GST Act). It contains transitional rules for the affected local authorities.

Three other amendments have been made to reflect the expiry of the Goods and Services Tax (Local Authorities Accounting on Payments Basis) Order 2009, and the introduction of this new section:

- section 19A(1)(a)(ii) has been repealed;
- section 19AB has been repealed;
- section 19C has been amended to include a cross-reference to new section 87.

Detailed analysis

When a GST-registered person changes from a payments basis to an invoice basis, section 19C sets out that they must perform a wash-up calculation based on their outstanding debtors and creditors at that time.

New section 87 contains transitional rules which will allow affected local authorities to spread payment of the amount calculated as a result of that wash-up calculation over 72 months. The 72-month period begins on 1 July 2013. The transitional provision is included to mitigate the potentially significant cashflow implications which would likely have arisen for the local authorities if they had had to pay the sum determined by the wash-up calculation in one instalment when the Order in Council expired.

Section 19AB has been repealed, as no further Orders in Council will be made to permit local authorities to account for GST on a payments basis. Consequentially, section 19A has also been repealed.

A cross-reference to new section 87 has also been included in section 19C of the GST Act.

Application dates

These amendments apply from the date of Royal assent, being 17 July 2013.

The repeal of section 19A applies from 1 July 2013.

AGENTS' "OPT-OUT" PROVISION

Sections 26 and 60(1B) of the Goods and Services Tax Act 1985

Background

The Goods and Services Tax Act 1985 (GST Act) currently only allows one tax invoice to be issued when a tax agent makes a taxable supply for, and on behalf of, a principal.

Some large accounting systems, however, automatically issue invoices when goods and services are supplied. The principal's accounting system might therefore issue a tax invoice when goods and services are provided to the agent, and the agent's accounting system might also issue a tax invoice when goods and services are provided to the recipient.

It is also not uncommon for an agent to issue a buyer-created tax invoice to a supplier, and also issue an invoice to a buyer in relation to that supply. When a recipient of goods or services creates a buyer-created tax invoice, that invoice is deemed to be provided by the supplier.

Both these examples illustrate a technical breach of the legislation.

Key features

When a principal and agent agree, under new subsection 60(1B), the supply is treated as being two separate supplies, and therefore two invoices may be issued.

Consequentially, a new subsection has been added to the bad debt rules. It prevents a principal who uses this new agency subsection from claiming a bad debt deduction if the agent has received payment for the supply.

Detailed analysis

When a principal and an agent agree that this new subsection applies to a supply of goods or services, the standard agency rule in section 60 (1) of the GST Act is modified. The general agency rule treats a supply made by an agent to be made by the principal. When this new subsection is used, however, the supply is treated as two separate supplies.

As a result of the amendment, both the principal and the agent can issue an invoice in respect of what would otherwise be treated as the same supply. This means that the principal will be able to issue a tax invoice to the agent, and the agent will be able to issue a tax invoice to the buyer. The principal will pay output tax on the "supply" to the agent. The agent will pay output tax on the "supply" to the buyer and claim input tax on the basis of the supplier's invoice to them.

The agreement between the principal and agent must be made in writing. It may relate to either a particular supply, or a type of supply.

A new subsection has also been added to section 26 of the GST Act. Section 26 sets out the conditions under which deductions may be made in relation to amounts which are written off as bad debts. The new subsection limits the ability of a principal who uses this new agency rule to claim bad debt deductions. A principal may not claim a bad debt deduction if the agent has been paid for the supply of the goods or services to the recipient.

There are revenue risks inherent in allowing supplies made through agents to be treated as two separate supplies, and two allowing invoices to be issued. The limitation on bad debt deductions is intended to be a protection mechanism against potential phoenix fraud schemes, and agents who go out of business. Without such a limitation, there is a risk that a GST liability could be avoided through an agency transaction in which both the principal and agent claim back input tax, but the agent disappears or goes out of business without returning output tax.

Application date

The amendments apply from the date of Royal assent, being 17 July 2013.

FARMERS' RIPARIAN PLANTING

Sections DO 1 and DO 2 of the Income Tax Act 2007

The amendments allows farmers an immediate deduction for riparian planting.

Background

Theoretically the Tax Act allows farmers a deduction spread over 45 years for riparian planting (planting beside waterways to help control run-off). In practice farmers were, we understand, generally taking an immediate deduction for such planting. Further, under the tax law before this amendment, the planting of trees for similar purposes was usually immediately deductible.

Key features

Section DO 2, which previously allowed farmers an immediate deduction for trees planted for erosion and shelter purposes, has been extended to also allow an immediate deduction for the planting of trees or plants for the purpose of:

- preventing or combatting erosion;
- providing shelter; and
- preventing or mitigating detrimental effects of water run-off.

The heading to section DO 1 was consequentially amended.

Application date

The general application date is expenditure incurred from the start of farmers' 2011–12 income year, but there is a grandparenting provision such that claims already made from the commencement of the 2008–09 income year are also allowed.

WRITE-OFF OF FARMERS' AND ORCHARDISTS' IMPROVEMENTS

Section DO 11 of the Income Tax Act 2007

The amendment extends to rules concerning the write-off of farmers' and orchardists' (collectively "farmers") improvements to address some of the issues highlighted by Kiwifruit PSAv.

Background

Section DO 11 was originally added to the Tax Act to allow the write-off of subpart DO capitalised improvements when they are made useless by events outside the control of the owner. The Kiwifruit PSAv outbreak caused this section to be re-examined.

It became clear that section DO 11 did not extend to the costs of removal, and there was doubt about the costs of associated structures that were destroyed because the kiwifruit vines had been rendered useless and the orchardist wanted to plant something else.

Key features

Section DO 11 has been amended to allow deductions for both the costs of removal of subpart DO capitalised improvements and their write-off when they are destroyed consequentially to being made redundant because the crop they were supporting had been made useless by an event (that is, the Kiwifruit PSAv). The criterion that the event is beyond the farmers' control still applies, but the event does not have to actually damage the improvement, but rather it consequentially makes the improvement redundant.

Application date

The amendments apply from the commencement of farmers' 2010–11 income year.

TRANSITIONAL IMPUTATION PENALTY TAX

Section 140C of the Tax Administration Act 1994

The amendment repeals the transitional imputation penalty tax.

Background

The transitional imputation penalty tax was introduced as part of the company tax rate change from 30% to 28%. The penalty was intended to protect the tax base by ensuring that companies do not deliberately over-impute dividends at 30% during the transitional period (from the 2011–12 income year to 31 March 2013) when they had not paid underlying tax at 30% or more. The one-off penalty was to apply on 31 March 2013.

The Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill contained a remedial amendment preventing overreach of the penalty. At the Select Committee stage of the Bill, concerns were raised in submissions that the penalty at 10% was excessive, especially when the core imputation penalty ensures that companies do not actually overdraw their imputation accounts. Further, the point was made the penalty was no longer necessary as it was preventative in nature and anyone who had transgressed had done so accidentally, whereas the penalty was intended to prevent deliberate over-imputation.

Key features

The amendment repeals the transitional imputation penalty tax. Repealing the penalty, rather than adjusting the penalty rate, is intended to minimise administrative implications, which were to arise from adjusting the penalty rate.

Companies who over-imputed dividends at 30% during the transitional period when they had not paid underlying tax at 30% or more are not subject to the transitional penalty tax. However, the core imputation penalty of 10% continues to apply to companies who overdraw their imputation accounts.

Application date

The amendment applies from 1 October 2010, which is when the transitional imputation penalty tax was introduced.

CLARIFICATION OF "DIVIDEND" DEFINITION

Sections CD29B and YA 1 (definition of "bonus issue") of the Income Tax Act 2007; sections CD 21BA and OB 1 (definition of "bonus issue") of the Income Tax Act 2004

The definition of "dividend" has been amended to make it clear that certain transactions should not be treated as dividends for tax purposes. The changes do not involve a change in policy but clarify the policy intent for the specified transactions.

Background

A dividend that is derived by a person is treated to be income. The current dividend definition is based on the policy that, in general, distributions from a company to a shareholder should be taxed if there is a transfer of value to the shareholder and the transfer is made in recognition of the shareholder's ownership interest in the company (instead of, for example, an employer/employee relationship between the company and shareholder).

Previously it was unclear whether certain transactions fell within the definition of "dividend". Amendments have therefore been made to clarify that certain transactions are not treated as dividends for tax purposes. The amendments do not involve a change in policy, nor do they imply that other arrangements fall within the dividend definition. The relevant transactions are described below:

Rights issues

Companies can offer their shareholders rights to buy new shares, generally at a discount to the market value.

Legislative changes have been made to make it clear that the discounted amount is not a taxable dividend for shareholders that exercise the right, and that the right itself (which has value and may in some cases be traded or renounced) is not a taxable dividend.

The policy rationale for ensuring that rights and discounted shares issued under a rights issue are not treated as dividends is that the company does not give up anything of value. A rights issue involves the company raising new equity when the shareholders invest new funds in the company.

Premiums paid under bookbuild arrangements

Following a rights issue, a bookbuild can take place. A bookbuild involves the rights of non-participating shareholders (who chose not to participate or were not entitled to participate) being offered to other investors who pay a premium for them. The original shareholder is paid all or part of this premium for giving up their rights.

Legislative changes have been made to make it clear that premiums paid under bookbuilds are not dividends for tax purposes. From a policy perspective, a bookbuild should not be treated as a dividend because, like a rights issue, the company does not give up anything of value.

Share splits

A share split involves a company diluting its shareholding whereby the shareholding proportions are retained but the shareholding is split into a greater number of shares.

The definition of "bonus issue" has been amended so that share splits that involve a subdivision of shares (that take place under the Companies Act 1993) can be excluded from the dividend definition. Previously, only bonus issues that involved the issue of new shares could be excluded from the definition of "dividend" for tax purposes. However, a subdivision of shares does not necessarily involve the issue of new shares.

From a policy perspective, a share split should not be treated as a taxable dividend because the company does not give up anything of value. Furthermore, in a subdivision of shares, the shareholder is generally not involved in a transaction with the company.

Key features

Two key changes have been made.

New section CD 29B of the Income Tax Act 2007 and CD 21BA of the Income Tax Act 2004 ensure that:

- under a rights issue, the discounted amount is not a taxable dividend for those shareholders that exercise the right;
- under a rights issue, the right itself (which has value and may in some cases be traded or renounced) is not a taxable dividend;
- premiums paid under bookbuilds are not dividends for tax purposes.

The legislative definition of "bonus issue" has also been amended to include not only the issue of new shares, but the subdivision of shares. The existing tax rules for taxable bonus issues and non-taxable bonus issues will then apply to subdivisions of shares.

Application date

The changes apply from 1 April 2005. This is when the Income Tax Act 2004 (containing the dividend definition) came into effect. Similar changes have been made to the Income Tax Act 2007.

GST RECORD-KEEPING REQUIREMENTS

Sections 75(3), 75(3BA), 75(6) and 75(7) of the Goods and Services Tax Act 1985

An amendment has been made to align the record-keeping provisions in the Goods and Services Tax Act 1985 (GST Act) with recent amendments to the record-keeping provisions in the Tax Administration Act 1994. The amendments to the GST Act:

- allow the Commissioner of Inland Revenue to authorise the storage of a registered person's GST records offshore through applications from their service provider; and
- allow the Commissioner to impose reasonable conditions for that authorisation.

Background

The purpose of the changes is to make it easier for taxpayers to conduct their GST compliance activities electronically and align the record-keeping provisions in the GST Act with recent amendments to the Tax Administration Act 1994.

The amendments to the Tax Administration Act allow Inland Revenue to authorise service providers (for example, a tax agent, accounting software provider or a data storage provider) to keep their clients records offshore, provided they meet the conditions set by the Commissioner of Inland Revenue's Standard Practice Statement SPS 13/01: *Retention of business records in electronic format, application to store records offshore and application to keep records in Māori.*

These amendments will help to simplify the new GST registration rules for non-residents.

Key features

Generally, a registered person is required to store their records in New Zealand. As registered persons are increasingly managing their taxes through payroll or accounting software, the use of offshore data storage for information, records and returns is growing. Previously, the Commissioner could only authorise applications from an individual registered person to store their records offshore. The amendments now align with recent amendments to the Tax Administration Act, to allow a data storage provider to apply to the Commissioner on behalf of their clients. This will make it easier for the registered person to store their data offshore if they choose. The Commissioner will also be able to revoke an authorisation, and has the flexibility to authorise the keeping of records in a different form if requested by a registered person or a data storage provider.

The SPS provides the administrative criteria for the authorisation under the Tax Administration Act. To avoid confusion and maintain consistency between the two Tax Acts, the administrative criteria outlined in the SPS also applies to applications and authorisations under the GST Act to keep a registered person's records offshore.

Under the new rules, registered persons will meet their record-keeping obligations only if they use Inland Revenue-approved service providers. However the ultimate obligation to comply with GST obligations will always rest with a registered person.

Application date

The amendment applies from 2 November 2012.

AMENDMENTS TO CHILD SUPPORT AMENDMENT ACT 2013

Sections 110B to 110H of the Child Support Amendment Act 2013

A small number of technical and remedial amendments have been made to the Child Support Amendment Act 2013 to correct errors, clarify provisions and to include additional consequential changes.

Background

Parliament enacted changes to the Child Support Act 1991 in April 2013 through the Child Support Amendment Act 2013. The key features of the Child Support Amendment Act 2013 are set out in *Tax Information Bulletin* Vol 25, No 5, June 2013.

Key features

An estimate of taxable income may not be accepted or revoked if an "income amount order" is in force. The definition of "income amount order" has been updated as a result of amendments to section 106 of the Child Support Act 1991, which identifies the orders that a court may make. The updated definition reflects that a receiving parent will also be able to make an estimate of taxable income. An "income amount order" is now defined as a determination or an order that substitutes a new child support income amount, an amount of taxable income or adjusted taxable income, or an annual amount of child support.

New section 4A(1) and new section 8(1) have been amended to clarify that a parent or carer cannot apply for a formula assessment of child support if they are living in a marriage, civil union or de facto relationship with the parent from whom payment of child support is sought. Where there are more than two legal parents of the child, and two of these parents are living together in a marriage, civil union or de facto relationship (for example, the applicant and a legal step-parent) an application for formula assessment can still be made, as long as the parent making the application is not in a relationship with the parent from whom payment is sought.

New section 17 defines a parent to be a receiving carer if their care cost percentage is greater than their income percentage, and a parent to be a liable parent if their income percentage is greater than or equal to their care cost percentage. The policy intent is for a parent with a zero care cost percentage and a zero income percentage to be liable for at least a minimum amount of child support, where there is a receiving carer providing at least 35% of ongoing care. Section 17 has been amended to ensure that a parent with 100% of the care costs of a child and 100% of the income is defined as a receiving carer, despite their income percentage being equal to their care cost percentage.

Amendments to new section 35 clarify the income to be used for assessing adjusted taxable income for a child support formula assessment as follows:

- The use of adjustments made to taxable income, as set out in new subsection 35(1), will apply to assessments of child support for the child support year starting 1 April 2015 and later child support years. For assessments of child support for the child support year starting 1 April 2014, the calculation of adjusted taxable income will be based on taxable income, without making any adjustments of the sort referred to in subsection 35(1).
- The most recent tax year will be reviewed when determining if a person's taxable income was derived only from withholding income and the person has no adjustments of the sort referred to in subsection 35(1). If, in the most recent tax year, the person meets these two criteria, their taxable income will be taken to be their employment income for the calendar year immediately preceding the start of the child support year.
- If the person does not meet the two criteria referred to above, their taxable income for a child support year must be their taxable income in the tax year immediately preceding the most recent tax year, including the inflation percentage for the child support year. Likewise, the adjustments under section 35(1) that must be applied are those that relate to the tax year immediately preceding the most recent tax year.
- Additional consequential amendments have been made to the definition of "last relevant tax year".

Additional consequential amendments to Part 6A and section 103B of the Child Support Act 1991 have been made to reflect that under a formula assessment for child support there can now be more than two parties affected.

Application date

The changes apply from 17 July 2013.

NEW LEGISLATION

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 13/09: WESTPAC NEW ZEALAND LIMITED

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

Name of the person who applied for the Ruling

This Ruling has been applied for by Westpac New Zealand Limited (Westpac).

Taxation Laws

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

This Ruling applies in respect of:

(a) ss BG 1, CC 4, CC 7, EW 15, EW 31, GB 21, RE 1 to RE 6, RE 10, RF 2 to RF 4, RF 12 and YA 1;

(b) part VIB of the Stamp and Cheque Duties Act 1971.

The Arrangement to which this Ruling applies

The Arrangement is a mortgage offset arrangement comprising a series of deposit accounts and a home loan account known as Choices Offset that Westpac intends to offer to its customers (Offset Arrangement).

The Offset Arrangement allows a customer to link several deposit accounts (known as Linked Deposit Accounts) to one of a variety of home loan accounts (known as a Choices Offset Loan), notionally offsetting the balances of the deposit accounts against the loan account balance to reduce the amount of interest payable to Westpac on the home loan account. Interest is not paid or payable on any Linked Deposit Accounts for as long as the account is linked to a Choices Offset Loan.

This Ruling does not consider the tax consequences of any arrangement under which a Linked Deposit Account holder agrees to offset their deposit account credit balance against another person's Choices Offset Loan account debit balance in return for valuable consideration (whether in monetary or non-monetary form).

Further details of the Arrangement are set out below.

Background

1. The Offset Arrangement is a "mortgage offset" arrangement. The customers who may participate are classified as either Restricted Entities or Non-restricted Entities. Special rules apply to each of the two participant entities. (These terms are explained in paragraphs 24 to 30.)
2. The Offset Arrangement allows Westpac customers to "link" up to 10 Linked Deposit Accounts to a single loan account such that the balances of the home loan and deposit account(s) will be notionally aggregated (thereby, notionally reducing the debit balance of the loan) for the purposes of calculating the amount of interest that accrues on the loan. Westpac will pay no credit interest on the linked deposit accounts during the period they are so linked, even where the deposit balances exceed the loan balance.
3. The Offset Arrangement is not a separate loan product; it is an arrangement that can be used with an existing home loan product and deposit accounts. Further details of the Offset Arrangement, particularly in relation to the eligible home loans and deposit accounts, interest calculations, interest rates, eligibility requirements of participants and relevant documentation are set out in the following paragraphs.

Eligible home loans that can be offset

4. Westpac offers its retail and business customers several loan products, including Choices Home Loans, which may have a fixed, floating or capped interest rate.
5. Westpac will determine from time to time which loan products may be included in an Offset Arrangement (such loans will be referred to as Qualifying Loans). Initially, only floating-rate Choices Home Loans will be included in the Offset Arrangement, but other Choices Home Loan types (excluding the Choices Everyday Loan) may be added in due course.

6. Qualifying Loans will have a variety of repayment options, including table, non-table and interest only. A Qualifying Loan included in an Offset Arrangement is referred to as a Choices Offset Loan.
7. The effect of offsetting is that interest will be payable on the lower notional principal balance of the Choice Offset Loan. In the case of:
    - a table loan, the term of the loan will be reduced;
    - a non-table loan, the interests payments will be reduced with any interest savings resulting in either a reduction of interest payments or (if any minimum periodical payments are maintained) a reduction in the term of the loan;
    - an interest-only loan, interest payments will be reduced.

Eligible deposit accounts that can be offset

8. Westpac also offers its customers a variety of deposit accounts, including transaction accounts and savings accounts. Westpac will determine, from time to time, which of these accounts may be included in an Offset Arrangement. Deposit accounts are not required to be new deposit accounts opened for the purpose of the Arrangement. Further, no new deposit account types will be created as part of the Offset Arrangement.
9. To participate in the Offset Arrangement, the deposit account (or accounts) has to be linked to a Choices Offset Loan. Under the Arrangement, a deposit account that has been linked to a Choices Offset Loan is referred to as a Linked Deposit Account.
10. Only one Qualifying Loan and up to 10 Linked Deposit Accounts may be included in an Offset Arrangement.

Offsetting features

11. The key feature of the Offset Arrangement is the "offsetting" of the aggregate credit balance of the Linked Deposit Account (or Accounts) against the debit balance of a Choices Offset Loan account, which occurs before interest is calculated.
12. A net notional balance will be calculated for the Choices Offset Loan before interest is calculated with interest accruing on that net notional balance only. This is the case as a matter of contract (as set out in the terms and conditions applying to the Offset Arrangement) and as a matter of practice (in terms of Westpac's internal systems and accounting).
13. There are no actual transfer of funds, no set-offs or netting of funds, and no transfer of any interest in, or entitlement to, funds between the Choices Offset Loan account and Linked Deposit Account (or Accounts).
14. The effect of offsetting is that interest will be payable on the lower notional principal balance of the Choices Offset Loan.
15. Financially, the consequences for a customer of linking one or more deposit accounts and a Choices Offset Loan in an Offset Arrangement or using Westpac's revolving home loan product (Choices Everyday Loan) are similar in terms of reduced interest costs. The balance on which interest is calculated is reduced, resulting in a reduced term of the loan for table mortgages and reduced periodical payments for non-table mortgages.

Interest calculations under a Choices Offset Loan

16. The balance on which interest shall accrue on any day under a Choices Offset Loan will be calculated by notionally reducing the debit balance of the Choices Offset Loan at the end of that day by an amount equal to the aggregate of the credit balances of each Linked Deposit Account at the end of that day.
17. If the aggregate of the credit balances of all Linked Deposit Accounts equals or exceeds the debit balance of the relevant Choices Offset Loan, no interest will accrue on the Choices Offset Loan.
18. No interest will accrue or be paid on the credit balance of a Linked Deposit Account for so long as it is linked to a Choices Offset Loan. This is the case irrespective of whether, on any given day, the aggregate of the credit balances of all Linked Deposit Accounts at the end of that day exceeds the debit balance of the Choices Offset Loan to which they are linked.
19. Interest will accrue on any Linked Deposit Account for any period that it is not linked to a Qualifying Loan. Clause 3 of the Offset Arrangement Agreement and Clause 2 of the Offset Arrangement Contributor Agreement make it clear that interest is suspended on Linked Deposit Accounts only for so long as they are linked to a Choices Offset Loan under those agreements.
20. Default interest will not be subject to the offsetting arrangement. It will continue to accrue in accordance with the standard terms and conditions that apply to any Choices Offset Loan.

Interest rate

21. The rate of interest applicable to a Choices Offset Loan will be a market rate that Westpac determines.

Eligible persons and entities

22. Under an Offset Arrangement, deposit accounts held by the following persons may be linked to a Choices Offset Loan:
    - the Borrower, that is, the person (or persons acting jointly) who has (have) taken out the Qualifying Loan to be included in the Offset Arrangement;
    - in limited circumstances (as discussed below), persons other than the Borrower (known as a Contributor).
23. For the purposes of this Ruling, a Borrower is a Restricted Entity or a Non-restricted Entity.

Restricted Entities

24. Where the Borrower under the Offset Arrangement is a Restricted Entity, deposit accounts held only by the Borrower can be offset against the Borrower's Choices Offset Loan account.
25. A Restricted Entity is:
    - any body corporate or other person, including a body of persons acting jointly, other than a natural person or two natural persons jointly who are 'Partners' (namely, two natural persons who are married, in a civil union or in a de facto relationship with each other); or
    - any person(s), including any natural person(s), who is/are acting in its/their capacity as the trustee(s) of a trust or executor(s) of an estate.
26. The effect of being a Restricted Entity is that only deposit accounts in respect of which the Borrower is the sole account holder can be linked to the Borrower's Choices Offset Loan.
27. In the case of a Borrower acting in its/their capacity as the trustee(s) of a trust or the executor(s) of an estate, deposit accounts held only by the Borrower in its/their capacity(ies) as the trustee(s) of the same trust or executor(s) of the same estate can be linked to its Choices Offset Loan.
28. By way of example, if ABC Limited has established an Offset Arrangement in connection with its Qualifying Loan, deposit accounts held only by ABC Limited may be linked to that loan. Further, if ABC Limited is a party to the Choices Offset Loan as trustee of a trust, deposit accounts held only by ABC Limited in its capacity as trustee of the same trust may be linked to that loan.

Non-restricted Entities

29. Where the Borrower is not a Restricted Entity (i.e. the Borrower is either a natural person or two natural persons jointly who are partners), deposit accounts which are held either individually or jointly by the Borrower, their partner (spouse, civil union or de facto partner), any of their children (or a child together with his or her partner), or any of their parents (or a parent together with his or her partner) can be linked to the Borrower's Choices Offset Loan. This is on the condition that such persons are not themselves Restricted Entities. This can be done by:
    - the Borrower where he or she (or they) can do so within the parameters of any linking rules determined by Westpac from time to time (which will require, among other things, that the Borrower has sufficient authority to operate the relevant deposit account);
    - the Borrower acting with the consent of the relevant Contributor, in circumstances where the linking rules determined by Westpac from time to time require the relevant Contributor's consent (which will be the case where the Borrower does not have sufficient authority to operate the relevant deposit account);
    - a Contributor, where the relevant deposit account is held by a Contributor and that Contributor has already provided consent in relation to another deposit account (and, therefore, has already signed up to the relevant terms and conditions under which the Borrower and the relevant Contributor agree that the Contributor may do so).
30. By way of example only, if Mr and Mrs Brown jointly establish a Choices Offset Loan:
    - deposit accounts held by Mr and Mrs Brown jointly may be linked to that Choices Offset Loan;
    - subject to any further criteria set by Westpac from time to time, deposit accounts held by Mr Brown in his individual capacity may be linked to that Choices Offset Loan (most likely by Mr Brown himself);
    - subject to any further criteria set by Westpac from time to time, deposit accounts held by Mrs Brown's father may be linked to that Choices Offset Loan by:
      - Mr and Mrs Brown, as the Borrower, with the consent of Mrs Brown's father; or
      - Mrs Brown's father, if Mrs Brown's father has already consented to another deposit account being linked to Mr and Mrs Brown's Choices Offset Loan;

- deposit accounts held by Mr Brown's father or by Mr Brown's father and his de facto partner jointly may be linked to that Choices Offset Loan (in accordance with relevant linking criteria above); and
- deposit accounts held by ABC Limited, or by Mr Brown in his capacity as a trustee, or any other Restricted Entity, cannot be linked to that Choices Offset Loan.

Offset Arrangement documentation

31. The terms and conditions of the Offset Arrangement are set out in the following documents provided to Inland Revenue on 27 March, 20 May and 13 June 2013.
32. The documents for the loan products included the:
    - Loan Summary (which contains particular and specific provisions relating to a loan facility that will be made available to a particular customer);
    - Westpac's terms and conditions for the relevant home loan product (which is a standard form master document that contains generic provisions that apply to all loans of a particular type).
33. The documents for the Offset Arrangement included the:
    - Offset Arrangement Agreement (being the principal agreement between the Choices Offset Loan customer and Westpac in relation to the Offset Arrangement);
    - Offset Arrangement Contributor Agreement (being the document that a Contributor signs in addition to Westpac and the Borrower to join an Offset Arrangement).
34. The Offset Arrangement documentation will override certain of the terms and conditions that would otherwise apply to the relevant Qualifying Loan and Linked Deposit Accounts that are included in an Offset Arrangement.
35. In particular, the Offset Arrangement Agreement sets out the interest calculation method to be used for the Choices Offset Loan, provides for no interest to accrue on Linked Deposit Accounts for as long as the account(s) are linked to a Choices Offset Loan, and sets out the eligibility criteria (in relation to loans, accounts and account holders).
36. Therefore, Westpac customers who wish to include a Qualifying Loan in an Offset Arrangement would enter into the standard loan documentation applicable to the Qualifying Loan as well as the Offset Arrangement documentation. A customer may not have an Offset Arrangement without a Qualifying Loan.

Condition(s) stipulated by the Commissioner

This Ruling is made subject to the following condition:

(a) All interest rates offered by Westpac in relation to an Offset Arrangement are at arm's length market rates.

How the Taxation Laws apply to the Arrangement

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

Financial arrangements rules

When, under the Offset Arrangement, a credit balance of a Linked Deposit Account and a debit balance of a Choices Offset Loan account are offset, no amount of consideration is paid or payable by virtue of that offset for the purposes of calculating income or expenditure under ss EW 15 and EW 31 of the financial arrangements rules (as defined in s EW 1(2)). Therefore, offsetting does not, of itself, give rise to any income or expenditure under the financial arrangements rules.

Resident withholding tax, non-resident withholding tax and approved issuer levy

There is no payment of, or entitlement to, interest (as defined in s YA 1) in relation to the credit balance(s) of Linked Deposit Account(s) in the Offset Arrangement. Therefore, no holder of a Linked Deposit Account derives any interest income on such accounts for the purposes of s CC 4, and Westpac does not pay any interest and has no obligation to deduct resident withholding tax or non-resident withholding tax under the Act or pay approved issuer levy under part VIB of the Stamp and Cheque Duties Act 1971.

Section CC 7

No income arises under s CC 7 for Westpac or its customers in relation to the Offset Arrangement.

Tax avoidance

Section BG 1 does not apply to the Arrangement.

Section GB 21 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 1 April 2013 and ending on 31 March 2017.

This Ruling is signed by me on the 9th day of July 2013.

John Trezise
Investigations Manager

PRODUCT RULING BR PRD 13/10: NEWMONT MINING NZ COMPANIES

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Newmont Mining NZ Companies (Consolidated Group) ("Newmont").

Taxation Laws

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

This Ruling applies in respect of sections CA 1(2), CB 1, CC 1(1), CD 1 and CE 1 of the Income Tax Act 2007.

The Arrangement to which this Ruling applies

The Arrangement is the payment to persons pursuant to the Amenity Effect Programme ("AEP").

Newmont is required to comply with the Resource Management Act 1991 ("the RMA"), which includes the obligation to minimise any adverse effect of its operations on the environment and its neighbours. Consequently, Newmont endeavours to use industry-leading methods to manage, monitor and record the effect of its operations on the environment and on others living in the vicinity of its operations. However, based on the results of monitoring and modelling, Newmont has identified properties within the area of the Martha, Favona and Trio mines whose amenity may be measurably affected by mining activity specifically by noise, dust and blast-induced vibration effects ("the affected area"). Newmont modifies the affected area on the basis of monitoring and modelling results.

In response to this, Newmont has developed the AEP the full details of which have been provided to Inland Revenue in a letter dated 7 June 2013. The details are not repeated here, save to note that the AEP is not compensation for non-compliance with any of the conditions imposed under the RMA.

Occupiers of residential property within the affected area are offered an opportunity to participate in the AEP. However, any Waihi resident may request to be included in the AEP. Their inclusion or exclusion will be based on the results of monitoring and modelling at their property over the six-month payment period or a period sufficient to confirm potential effects on amenity.

Inclusion in the AEP is voluntary and an application to participate in the AEP can be made at any time.

Residents who apply to participate and are accepted into the AEP ("enrolled residents") will receive an initial one-off "enrolment payment". The enrolment payment is currently $500.

Enrolled residents are eligible for six monthly retrospective effect based payments for both noise and vibration effects based on its routine environmental monitoring results.

Where the enrolled resident is a tenant they must reside in the property for six months before being eligible for any AEP payment.

The quantum of the effect based payments will vary with the actual loss of amenity experienced. If there is no effect, or the effect is to a greater or lesser extent, the payment will be varied.

Payments are carefully targeted to compensate for adverse amenity effects that residents have suffered.

Assumptions made by the Commissioner

This Ruling is not subject to any assumptions.

Conditions stipulated by the Commissioner

There are no conditions stipulated by the Commissioner.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

The payments received by persons under the AEP are not income under sections CA 1(2), CB 1(1), CC 1(1), CD 1 and CE 1 of the Income Tax Act 2007.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2013 to 31 March 2016.

This Ruling is signed by me on 23 August 2013.

Gary Welsh
Investigations Manager, Investigations and Advice

OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject.

2013 REVIEW OF THE COMMISSIONER'S MILEAGE RATE FOR EXPENDITURE INCURRED FOR THE BUSINESS USE OF A MOTOR VEHICLE

Operational Statement 09/01 published in the *Tax Information Bulletin* Vol 21, No 3 (May 2009) provides the Commissioner's statement of a mileage rate for expenditure incurred for the business use of a motor vehicle (OS 09/01 can be viewed at Inland Revenue's website **www.ird.govt.nz/technical-tax/op-statements/**). This Operational Statement provides that the Commissioner will review the mileage rate on a yearly basis.

Inland Revenue has reviewed the motor vehicle mileage rate to reflect the average cost of running a motor vehicle, including the average fuel prices, and advises the mileage rate for the 2013 income year will remain at 77 cents per kilometre for both petrol and diesel fuel vehicles.

The Commissioner is required by statute to set a mileage rate for persons whose business travel is 5,000 or less in an income year. The mileage rate is set retrospectively for persons required to file a return for business income, so that the rate reflects the average motor vehicle operating costs for an income year. Those persons who meet the criteria have a choice of using the Commissioner's mileage rate or use actual costs if they consider that the Commissioner's mileage rate does not reflect their true costs. Taxpayers that choose to use actual costs are required to keep records to support any expenditure claimed.

The Commissioner accepts that employers may use the 2013 vehicle mileage rate as a reasonable estimate of costs when they reimburse employees for the use of their private vehicle for business related travel.

Also, employers may use an alternative estimate other than the Commissioner's vehicle mileage rate when reimbursing employees for use of their private vehicle for employment related use. It is accepted that employers may use the motor vehicle running cost data published by other reputable sources, for example the New Zealand Automobile Association Incorporated, as an alternative reasonable estimate for reimbursement of employees.

The mileage rate does not apply in respect of motor cycles.

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.

COURT OF APPEAL CONFIRMS HIGH COURT DECISION

Case	Strategic Finance Limited (in rec & in liq) v Commissioner of Inland Revenue [2013] NZCA 357
Decision date	9 August 2013
Act(s)	Companies Act 1993, Personal Property Securities Act 1999
Keywords	Definition of "accounts receivable"

Summary

The Court of Appeal confirmed the High Court decision that "accounts receivable" is not limited to "book debts" overturning the decision in *Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq)* (2008) 23 NZTC 22,074 (HC) (*"Northshore"*).

Impact of decision

The decision affirms that the Commissioner of Inland Revenue ("the Commissioner"), as preferential creditor, will have priority over a secured creditor in this context.

Facts

Takapuna Procurement Limited (in liquidation) ("Takapuna") was a property development company involved in the development of a property at Anzac Avenue, Takapuna known as "Shoalhaven". Takapuna's directors were Messrs Robert and Kelly McEwan who were adjudicated bankrupt as of 26 February 2009 and May 2009 respectively.

Strategic Finance Limited (in receivership and in liquidation) and Strategic Nominees Limited (in receivership) ("Strategic") advanced funds to Takapuna for the completion of Shoalhaven. At the date of Takapuna's liquidation, Strategic was owed in excess of $4,800,000 plus interest and costs secured by a registered General Security Agreement.

Strategic is the only remaining secured creditor of Takapuna and the Commissioner the only remaining preferential creditor in the liquidation. The dispute relates to various categories of funds totalling $782,108.18 plus accrued interest.

The funds in question held by Messrs Burns and Agnew (the liquidators) were made up as follows:

- refunds to Takapuna from the North Shore City Council ("NSCC") of development contributions ($451,176.94) and bonds ($3,000);
- a goods and services tax ("GST") refund of $169,349.86 released by the Commissioner to Takapuna in error; and
- various funds held by Takapuna's solicitors which related to earlier property developments ($158,581.38).

In the High Court, Strategic argued that the Commissioner's claim to the funds as a preferential creditor was limited to "book debts". Strategic also argued that the GST refund released in error by the Commissioner of $169,349.86 should not in any event be repaid to the Commissioner. These claims were rejected by the Court, Gendall AJ finding in favour of the Commissioner. The grounds for his decision were:

a) it would be unfair and unconscionable for the GST refund of $169,349.86 to be retained by the liquidators;

b) the expression "accounts receivable" in schedule 7, clause 2(2) of the Companies Act 1993 is not limited to book debts; and

c) the funds held by the liquidators of Takapuna were "accounts receivable" and therefore payable to the Commissioner as the only preferential creditor.

Strategic challenged each of these grounds, but advanced their appeal first through grounds (b) and (c). Ground (a) arises only if Strategic is successful in their challenge to grounds (b) and (c).

Decision

In the High Court decision, Gendall AJ concluded that the term "accounts receivable" was not limited to book debts, overturning the decision of Hole AJ in *Northshore*. The High Court held that the Companies Act 1993 expressly adopts section 16 of the Personal Property Securities Act 1999 definition of "accounts receivable". If Parliament had intended to limit "accounts receivable" to "book debts", it would have done so expressly.

The Court of Appeal accepted the interpretation of the High Court. They held that the definition included, but was not limited to, debts or "book debts". It would also include other legally enforceable rights under deeds, statutes and other court judgments whether or not earned by performance. They also held that money held in a bank account would be an "account receivable" because the bank will be under a legally enforceable obligation to pay the money to the account holder.

The Court of Appeal then applied the definition to the funds in this case. They held that the crucial date for determining whether the funds constituted "accounts receivable" was the date on which Takapuna was placed into liquidation.

Development contribution refunds

The NSCC had acted *ultra vires* in collecting development contributions from Takapuna relying on its 2004 development contributions policy (carried over into its 2006 policy). As confirmed in *Woolwich Equitable Building Society v Inland Revenue Commissioners (No 2)* [1993] AC 70 (HL) at [103]–[104], because the NSCC had collected funds from Takapuna unlawfully, the amount paid was repayable at the exact moment it was paid. Accordingly, the Court of Appeal held that the refunds of the development contributions constituted monetary obligations within the definition of "accounts receivable" and should be paid to the Commissioner as the remaining preferential creditor.

Engineering and constructions bonds

Bonds of $3,000 paid by Takapuna were lawfully received by the NSCC in securing the performance of resource consents. The NSCC was not satisfied that the development complied with its standards until after the liquidation of Takapuna. The Court of Appeal held that, as at the date of the liquidation, they were not a monetary obligation of the NSCC and therefore not "accounts receivable" to be collected by the Commissioner as a preferential creditor.

GST refunds

At all materials times, Takapuna had GST arrears exceeding $3,600,000. The Commissioner is entitled to offset this debt against any credits Takapuna could raise in subsequent or prior periods. Takapuna had no right to recover that refund; the GST refund was not an existing monetary obligation within the definition of "accounts receivable". However, the Commissioner could recover the mistaken refund based on restitution principles and the rule in *Re Condon, ex parte James* (1974) LR 9 Ch App 609 (CA).

Carter Atmore funds

The money held in the Carter Atmore (Takapuna's lawyers) trust account was determined "accounts receivable" because Carter Atmore, like a bank, is under a legally enforceable obligation to pay the money to Takapuna.

SUPREME COURT DECLINES LEAVE TO APPEAL ON CHILD SUPPORT PROCEEDING

Case	Beavis v De Vere and the Commissioner of Inland Revenue
Decision date	19 August 2013
Act(s)	Child Support Act 1991, Supreme Court Act 2003
Keywords	Child support, leave to appeal, retrospective departure orders

Summary

The Supreme Court declined leave to appeal from the Court of Appeal upholding a child support departure order.

Impact of decision

Although the Supreme Court declined leave to appeal given how the proceedings were run by the parties in the lower courts, the Court noted the issue of whether there is jurisdiction to make a retrospective departure order is an important one and that grounds for departure under section 105 of the Child Support Act 1991 can be questions of law.

Facts

This matter involved the question of whether income from an arrangement entered into by the applicant (involving the transfer of his business to a family trust and the consequential reduction of his personal income) should be taken into account in assessing the applicant's liability under the Child Support Act 1991.

The Family Court (*EJD v AJB* FC Auckland FAM-2004-004-002183) upheld the first respondent's application for departure from the formula assessment, ordering the application to make a lump sum payment. The High Court (*B v X* 920110 2 NZLR 405 (HC)) upheld the applicant's appeal, reducing considerably the child support orders made by the Family Court. The Court of Appeal (*EJD v AJCB* [2013] NZCA 100, [2013] NZFLR 325) took a similar view to that of the Family Court and upheld the first respondent's appeal.

The applicant sought leave to appeal the judgment of the Court of Appeal.

Decision

The Supreme Court dismissed the application for leave to appeal on the basis that none of the grounds for appeal raise issues of principle that qualify for a further appeal under section 13 of the Supreme Court Act 2003.

In addition, the Court considered that:

- despite the importance of the issue of the Court's jurisdiction to make retrospective orders, it would be unfair to give the applicant leave to appeal that point given the applicant did not seek to argue the issue by way of cross-appeal in the Court of Appeal (despite direction given by the Court of Appeal to do so)
- while the test under section 105 of the Child Support Act 1991 potentially raises intermingled questions of law and fact, the issues at each stage of the proceedings were treated as involving questions of fact and the current challenge was effectively factual, being confined to the particular circumstances of the case. Consequently legal questions regarding the scope of section 105(2) do not squarely arise.

Accordingly, the Court considered that it was not necessary in the interests of justice, in terms of section 13 of the Supreme Court Act 2003, to grant the application for leave.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Legal and Technical Services

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

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

Policy Advice Division

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

Litigation Management

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

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