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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED0151	Draft standard practice statement: Finalising agreements in tax investigations	This draft Standard Practice Statement sets out the principles and parameters for finalising agreements in tax investigations. In particular, it sets out how taxpayers and Inland Revenue staff should seek to resolve matters which are in doubt or in dispute when an investigation is being finalised. Once finalised, this Standard Practice Statement will update and replace Standard Practice Statement IR-SPS INV-350 "Finalising agreements in tax investigations", issued in *Tax Information Bulletin* Vol 10, No 8 (August 1998).	30 September 2014

IN SUMMARY

Binding rulings

Product ruling BR Prd 14/08: Body Corporate 358851 4

This product ruling concerns the GST treatment of a payment received by unit owners. The payment was from a body corporate which received an insurance payment following the Canterbury Earthquakes. The body corporate decided not to reinstate the building.

Standard practice statements

SPS 14/01: Tax payments – when received in time 6

This SPS replaces "SPS 07/01 Tax payments – when received in time". It sets out Inland Revenue's practice for accepting tax payments as having been received in time. This SPS contains several changes to the way in which payments made by post and payment made at Westpac branches will be administered. Those changes will take effect from 1 October 2014.

Legislation and determinations

Special Determination S27: Convertible Notes in respect of a limited partnership interest 8

This determination relates to the subordinated convertible notes (Convertible Notes) issued by the Holding Partnership to Limited Partner A which will convert to a 45% partnership interest at a single or several nominated dates in the future to match the partnership contributions by Limited Partner B and some of the partnership contributions by Limited Partner C. The Convertible Notes are being issued to provide equity funding to the Holding Partnership as part of an arrangement involving the finance, design, construction and ongoing operation of the facility by the Partnership under a public-private partnership agreement with the Crown.

Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership 11

This determination relates to an arrangement involving the finance, design, construction and on-going provision of operation and maintenance services in respect of the Facility by a limited partnership (the Partnership) under a public-private partnership agreement with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership. The limited partners in the Holding Partnership are Limited Partner A, Limited Partner B and Limited Partner C. This determination does not apply to Limited Partner C.

Special Determination S29: Application of the financial arrangements rules to a public-private partnership 14

This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of operation and maintenance services in respect of the Facility by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership. The limited partners in the Holding Partnership are Limited Partner A, Limited Partner B and Limited Partner C. This determination does not apply to Limited Partner C.

This determination prescribes: The amount of consideration that is solely attributable to the Facility Lease; how the financial arrangements rules apply to the O&M Phase of the Project Agreement, the Construction Agreement and the O&M Contract; and the method for spreading the payments made under the Bank Debt, Term Debt Facility and Interest Rate Swaps.

Legislation and determinations (continued)

General Depreciation Determination DEP89: Bench-top pizza ovens and microwave ovens (commercial) 18

The Commissioner has set general depreciation rates for bench-top pizza ovens and microwave ovens (commercial) by adding new asset classes to the "Hotels, motels, restaurants, cafes, taverns and takeaway bars" and "Shops" industry categories.

Questions we've been asked

QB 14/07: Tax Administration Act 1994 – proscribed questions 19

This item considers whether the Commissioner is able to include a statement relating to a proscribed question in a private or product ruling, and concludes that the Commissioner can include a statement relating to a proscribed question as a condition, assumption or in the description of the Arrangement.

QB 14/08: Income tax – costs of demolishing an existing building on a building site 22

This QWBA explains that the costs of demolishing an existing building on a building site are on capital account and are not deductible under the general permission. This QWBA also explains that, under the current depreciation rules, the costs of demolition are taken into account in determining the consideration received by a taxpayer for the disposal of a demolished building.

Legal decisions – case notes

Sufficient connection – section DA 1 of the Income Tax Act 2004 25

The Commissioner of Inland Revenue ("the Commissioner") disallowed interest deductions claimed by the appellant, Ean Innes Brown, in the 2005 to 2007 income tax years. The Taxation Review Authority and now the High Court have upheld the Commissioner's assessments disallowing the interest deductions due to there being an insufficient connection between the deductions and the appellant's income-earning process.

Nexus – section DA 1 of the Income Tax Act 2004 26

The Commissioner of Inland Revenue ("the Commissioner") disallowed interest deductions claimed by the appellant, P L Brown Farms Limited, in the 2006 and 2007 income tax years. The Taxation Review Authority and now the High Court have upheld the Commissioner's assessments disallowing the interest deductions due to there being an insufficient connection between the deductions and the appellant's income-earning process.

Duplicative claims struck out, security for costs ordered 27

The Commissioner of Inland Revenue ("the Commissioner") successfully had a new cause of action struck out of the pleading because it was duplicative of other proceedings and an abuse of process. The Forest Trust was ordered to pay security for costs, as it had provided no evidence that it would be able to satisfy a costs order should it prove unsuccessful on its claims.

Income – onus on disputant 29

The disputant claimed that apart from wages and interest earned in 2000 and 2001, he had not earned any money since 1988. The disputant gave evidence of having received inheritances and money from friends and family so that he could spend his time on charitable work. He also gave evidence of having withdrawn money from his various banks accounts and deposited it in his Global Plus accounts.

The Taxation Review Authority ("TRA") found that the disputant had not discharged his onus of proof to satisfy the TRA that the deposits are not income. In addition the TRA found that the disputant knew that he could rely upon gifts to fund his living expenses and to be able to continue his charitable activities. He accepted these gifts and used the funds to live on. On this basis, the TRA considered the amounts were income.

Legal decisions – case notes (continued)

No invoice where contract conditional 30

The vendors of subdivided lots issued documents headed "GST Tax Invoice" before the agreements for sale and purchase of those lots became unconditional. The Taxation Review Authority held that an invoice required a debt due, which occurred only when the vendor had completed all steps necessary to demand payment.

Privilege for in-house legal advice not waived 31

The High Court dismissed the application. The Court found that advice provided to the Commissioner of Inland Revenue ("the Commissioner") by an in-house lawyer was privileged. Privilege in the legal advice had not been waived by the Commissioner.

Application by Trinity investors to strike out or stay Commissioner's liquidation proceedings 32

Courtney J dismissed the defendants' application to strike out or stay the Commissioner of Inland Revenue's ("the Commissioner") liquidation proceedings. She found the Commissioner was a creditor for the purposes of recovering tax and further that the application to appoint liquidators was not premature on the part of the Commissioner.

Claims struck out for being filed out of time 34

The disputants' claims in relation to income tax assessments are struck out for being filed out of time. The disputants have 14 days to decide whether to pursue claims in respect of shortfall penalties.

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 14/08: BODY CORPORATE 358851

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Body Corporate 358851.

Taxation Laws

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

This Ruling applies in respect of ss 5(13), 8 and 76.

The Arrangement to which this Ruling applies

The Arrangement is:

- The receipt by Body Corporate 358851 (Body Corporate) of money (Insurance Payment) from its insurer in settlement of a claim for damage to the building or buildings (Building) at 187 Cashel Street, Christchurch, being a unit title development of 129 units (Property) and loss of rents caused by the Canterbury earthquakes of 2010 and 2011 (Earthquakes).
- The Body Corporate resolving on 26 July 2013 (Resolution):
  - not to reinstate the Building; and
  - to distribute the material damage portion of the Insurance Payment (net of certain costs) to owners of units in the unit title development (Owners) in accordance with their ownership interests in the Property.
- The distribution of an amount equivalent to the material damage portion of the Insurance Payment (net of costs) to Owners in accordance with the Resolution (Distribution).

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

Background to the Arrangement

1. The Property is a unit title development under the Unit Titles Act 2010. The Body Corporate is the body corporate for the Property. The Body Corporate is not registered under the Goods and Services Tax Act 1985.

   The Body Corporate insured the Building with an insurer, Zurich Australian Insurance Ltd trading as Zurich New Zealand (Insurer), for periods on the terms, conditions, and limitations in policy number 99 2783578 ISR (Insurance Policies). The Insurer is resident in New Zealand for GST purposes and the supply of the Insurance Policies to the Body Corporate was charged with tax under s 8(1) of the Goods and Services Tax Act 1985. The Body Corporate (not each Owner) is named in the Insurance Policies as the insured party.
2. The Earthquakes caused material damage to the Building and other improvements at the Property and resulted in loss of rents for the owners of the units.
3. The Body Corporate made a claim under one of the Insurance Policies in respect of the material damage to the Building and other improvements at the Property and loss of rents (Claim). The Body Corporate negotiated a settlement of the Claim with the Insurer on 12 September 2013 (Settlement Agreement). Under the Settlement Agreement the Insurer agreed to pay the Body Corporate an amount (including GST, if any) in full and final settlement of the Claim and any other existing or future liability of the Insurer under the Insurance Policies or otherwise in relation to loss, damage, or liability arising from the Earthquakes.
4. The Body Corporate was required to apply money received under the Insurance Policies in or towards the reinstatement of the Building unless it decided otherwise by special resolution at a general meeting (s 136(4) of the Unit Titles Act 2010). On 26 July 2013, the Body Corporate resolved:
   - not to reinstate the Building; and
   - to distribute the material damage portion of the Insurance Payment (net of costs) to Owners in accordance with their ownership interests in the Property.

5. The majority of the Owners are registered under the Goods and Services Tax Act 1985.
6. The Minister for Canterbury Earthquake Recovery had previously given notice of intention to compulsorily acquire the Property under s 54 of the Canterbury Earthquake Recovery Act 2011 (see the *New Zealand Gazette*, No 26, 7 March 2013 at 714). The Canterbury Earthquake Recovery Authority (CERA) established by the State Sector (Canterbury Earthquake Recovery Authority) Order 2011 reached agreement with the majority of the Owners to acquire their units. Settlement of the purchase by CERA of 113 of these units has now been completed.
7. CERA and the Owners agreed that the purchase price to be paid by the CERA to each Owner would broadly be calculated based on the current market value of the Owner's unit or units on an as–repaired basis less the amount distributed to each Owner under the Resolution.

Diagram of the Arrangement

8. The following diagram summarises how the Arrangement operates:

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Insurance Payment made by the Insurer to the Body Corporate under the Settlement Agreement is not a payment that has been received by a GST registered Owner for the purposes of s 5(13).

b) A Distribution by the Body Corporate to a GST registered Owner is not a payment received by a GST registered Owner under a contract of insurance for the purposes of s 5(13).

c) A Distribution by the Body Corporate to a GST registered Owner is not consideration for a taxable supply made by the Owner to the Body Corporate for the purposes of s 8.

d) A Distribution by the Body Corporate to a GST registered Owner is not consideration for a taxable supply made by the Owner to the CERA for the purposes of s 8.

e) Section 76 does not apply.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 30 May 2014 and ending on 30 May 2017.

This Ruling is signed by me on the 28th day of July 2014.

Howard Davis
Director (Taxpayer Rulings)

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 14/01: TAX PAYMENTS – WHEN RECEIVED IN TIME

Introduction

1. This Standard Practice Statement ("SPS") sets out Inland Revenue's practice for accepting tax payments as having been made in time. It contains several amendments to the previous SPS, particularly in relation to payments by post and payments made at Westpac. Those changes will take effect from 1 October 2014.

Application

2. This SPS replaces "SPS 07/01 Tax payments – when received in time", which was published in *Tax Information Bulletin* Vol 19, No 2 (March 2007).

Background

3. SPS 07/01 sets out when Inland Revenue would accept payments as having been received in time, including:
   - Payments by post
   - Electronic payments (from New Zealand and overseas)
   - Physical delivery
   - Cash and Eftpos payments
   - Post-dated cheques
   - Weekends and public holidays
   - Tax pooling
   - Tax transfers.

4. Since SPS 07/01, the GST and provisional tax payment due dates have been aligned. The objective of these changes was to make tax compliance easier for small businesses that operate in New Zealand.

Standard Practice

5. This SPS applies to all tax types, including goods and services tax ("GST") and child support payments.

Payments by post

6. Payments posted to an Inland Revenue postal address, whether they have been posted from within New Zealand or from overseas, must be received on or before the due date.

New Zealand electronic payments

7. Taxpayers may make payments electronically, including by internet banking. A payment will be received in time when it has been electronically paid or direct credited into an Inland Revenue account either on or before the due date.

8. Internet payments must be completed prior to the end of the bank's online business hours to be recorded as received on that specific day. Internet payments after these online business hours will be processed on the next business day.

9. In the context of electronic payments, "business hours" means the hours a bank makes available to customers to initiate electronic payments on any given day. Payments made after the bank's online business hours will be processed by the bank on the next business day.

Overseas electronic payments

10. A payment will be received in time when it has been electronically paid or direct credited into an Inland Revenue account either on or before the New Zealand due date.

Physical delivery

11. Cheque payments will be accepted as being received in time if delivered to an Inland Revenue office on or before the close of business on the due date. Payments by cash must be made at a Westpac branch.

Cash and Eftpos payments

12. Taxpayers may also make payments by cash or by Eftpos at most branches of Westpac. Payments can only be made over the counter and the payment is received in time if it is made by the close of business on the due date. (Note: While payment of tax may be made at Westpac branches, Westpac is not authorised to accept returns. Returns may be filed electronically, posted to Inland Revenue or delivered to an Inland Revenue office.)

Post-dated cheques

13. Inland Revenue will not bank post-dated cheques until the specified date. A cheque that is post-dated until a date after the due date, even though it may have been received on or before the due date, will be treated as late. This applies to payments that are posted or physically delivered.

Weekends and public holidays

14. If a due date falls on a weekend or a public holiday (including a provincial anniversary day), Inland Revenue will accept a payment as being in time if it is received at an Inland Revenue office, at a Westpac branch that will accept Inland Revenue payments or at an Inland Revenue postal address on the next working day.
15. If a due date falls on a weekend or a public holiday (including a provincial anniversary day), then an electronic payment will be accepted as being in time when it is credited into an Inland Revenue account on or before the next working day.

Tax pooling

16. Tax pooling involves taxpayers depositing money with a tax pooling intermediary who then deposits that money into a tax pooling account with Inland Revenue. These deposits are not tax payments at this stage. It is when a payment is transferred from the tax pooling account into the taxpayer's tax account that it becomes a tax payment. The date of payment to Inland Revenue is triggered when the tax pooling deposit is transferred into the taxpayer's account. The effective date of the transfer can be no earlier than the date the deposit was received by Inland Revenue. For more information on the implications of tax pooling refer to *Tax Information Bulletin* Vol 15, No 5 (May 2003) and Vol 23, No 8 (October 2011).

Tax transfers

17. For the rules regarding the transfers of overpaid taxes refer to *Tax Information Bulletin* Vol 14, No 11 (November 2002), Vol 16, No 1 (February 2004) and Vol 17, No 1 (February 2005).

This Standard Practice Statement is signed on the 25th day of July 2014.

Rob Wells
LTS Manager, Technical Standards

LEGISLATION AND DETERMINATIONS

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

SPECIAL DETERMINATION S27: CONVERTIBLE NOTES IN RESPECT OF A LIMITED PARTNERSHIP INTEREST

This determination may be cited as Special Determination S27: Convertible Notes in respect of a limited partnership interest.

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

1. This determination relates to the subordinated convertible notes (Convertible Notes) issued by the Holding Partnership to Limited Partner A which will convert to a 45% partnership interest at a single or several nominated dates in the future to match the partnership contributions by Limited Partner B and some of the partnership contributions by Limited Partner C. The Convertible Notes are being issued to provide equity funding to the Holding Partnership as part of an arrangement (the Project) involving the finance, design, construction and ongoing operation of the facility by the Partnership under a public-private partnership agreement with the Crown.
2. Limited Partner A and Limited Partner C have agreed that Limited Partner A will have the option to sell up to 9.9% of the equity interest in LP1 (along with up to 9.9% of the shareholding in General Partner 1, in equal proportions) to Limited Partner C. It is envisaged that if the option is exercised it will be exercised after the Convertible Note has converted to committed capital, noting that early exercise rights do exist in limited situations.
3. The Convertible Notes will earn a fixed rate of interest that is payable monthly (Coupon Interest Payments) until the Convertible Notes are converted. The Coupon Interest Payments will be capitalised on each interest payment date but will be paid to Limited Partner A on the first partnership distribution date, and therefore will not convert to a partnership interest.
4. The conversion to a partnership interest will be effected by way of a mandatory set off. Limited Partner A's obligation to make its capital contribution(s) will be satisfied by setting off that obligation against the Holding Partnership's obligation to repay that portion of the Convertible Notes equal to the capital contribution(s) required to be made on the relevant date.
5. The rate of interest will be an arm's length rate determined under an agreed rate setting process.
6. No commitment fees or upfront fees are payable on the Convertible Notes.
7. In accordance with s EW 6(2) an amount (whether it is income, consideration, gain, loss or expenditure) that is solely attributable to an excepted financial arrangement is not taken into account under the financial arrangement rules.
8. As an interest in a partnership is an excepted financial arrangement under s EW 5(11), only the Coupon Interest Payments are regarded as income or expenditure for the purposes of calculating accrual income or expenditure.
9. This Determination prescribes a method for determining the part of the consideration receivable by the parties to the arrangement that is solely attributable to the excepted financial arrangement as well as the method for spreading the accrual income, gain or loss, or expenditure under the financial arrangement rules.

2. Reference

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

3. Scope of determination

1. This determination applies to the Convertible Notes issued by the Holding Partnership to Limited Partner A as part of the Project (which is set out in detail in Private Rulings BR Prv 14/31 and BR Prv 14/32 issued on 25 July 2014). The terms of the Convertible Notes are as follows:
   - Limited Partner A will loan an amount to the Holding Partnership (subject to the prevailing market rates at Financial Close) with repayment being set off against the obligation to make capital contribution(s) in respect of a 45% interest in the Holding Partnership at a single or several nominated

dates in the future. The Convertible Notes will have a face value equal to 45% of the total equity requirement (being all of Limited Partner A's 45% interest in the Holding Partnership).

- The Convertible Notes will earn a fixed rate of interest that is payable monthly until conversion, defined as the construction swap rate exclusive of charges, plus a margin. For Financial Close, the construction swap rate will be calculated based on the prevailing swap rates as determined by standard market methodology.
- The Coupon Interest Payments will be capitalised on each interest payment date, and paid out to Limited Partner A on the first partnership distribution date, that is, the Coupon Interest Payments will not convert to a partnership interest.
- The rate of interest will be an arm's length rate determined under an agreed rate set process.
- No commitment fees or upfront fees are payable on the Convertible Notes.
- The Convertible Notes (and any interest payable on the Convertible Note) are subordinated to senior debt. After conversion of the Convertible Notes, Limited Partner A will rank equally with Holding Partnership contributions made by the other limited partners.

2. This determination is made subject to the condition that the executed documentation is not materially different from the final documentation that was provided to Inland Revenue on 23 July 2014 to the extent that it impacts on the scope of the determination or the application of the financial arrangement rules to the Applicants and the scope of the determination.

4. Principle

1. The Convertible Notes have both debt and partnership interest components. They can be regarded alternatively as:
   - a loan to a partnership with repayment by way of an interest in a partnership (debt component); or
   - a forward purchase of a partnership interest (in which case the holder of the Convertible Notes is buying an interest in the partnership).

   The financial arrangement rules in the Act classify an interest in a partnership as an excepted financial arrangement under s EW 5(11).
2. As the Convertible Notes have this dual character, when calculating income derived or expenditure incurred in relation to the Convertible Notes it is first necessary to separate the debt and partnership interest components of the Convertible Notes.
3. This determination specifies that, apart from the Coupon Interest Payments, all amounts relate to the underlying interest in a partnership, and will not be dealt with under the financial arrangement rules (subpart EW) when calculating income derived or expenditure incurred.
4. Income and expenditure in respect of the Convertible Notes is calculated by daily apportionment of the Coupon Interest Payment to income years in accordance with *Determination G1A: Apportionment of Daily Income and Expenditure*.
5. For the purposes of this determination it is assumed that any change in the market value of the interest in the partnership between the issue date of the Convertible Notes and the conversion into the partnership interest relates to the partnership interest component and therefore can be ignored when calculating income derived or expenditure incurred under the financial arrangements rules.

5. Interpretation

1. In this determination, unless the context otherwise requires:
   - "Coupon Interest Payment" means any amount payable on the Convertible Notes by the Convertible Note issuer (borrower) to the Convertible Note holder (lender) other than payments relating to the redemption or conversion of the Convertible Notes.
   - "Financial Close" has the same meaning as set out in the Project Agreement referred to in Private Rulings BR Prv 14/31 and BR Prv 14/32.
   - "Limited Partner A" is the holder of the Convertible Notes.
   - "the Holding Partnership" is the issuer of the Convertible Notes.
   - "Subordinated Convertible Notes" or "Convertible Notes" means the arrangement described in clause 3(1) of this determination.
   - All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
2. For convenience, words and phrases defined in this determination are indicated by initial capital letters, but the absence of a capital letter shall not alone imply that the word or phrase is used with a meaning different from that given by its definition.

6. Method

1. Amounts to be included when calculating income or expenditure under the financial arrangements rules with regard to the Convertible Notes in respect of income, gain or loss, or expenditure, and also of any other consideration receivable by the holder or payable by the issuer, consist of the Coupon Interest Payments.
2. The income derived or expenditure incurred in respect of the Convertible Notes shall be calculated by daily apportionment of the Coupon Interest Payments to income years. The required method is outlined in *Determination G1A: Apportionment of Daily Income and Expenditure.*
3. All other income, gain, loss, expenditure or consideration paid under or with respect to the wider financial arrangement is solely attributable to the excepted financial arrangement component of the wider financial arrangement.

7. Example

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

The example assumes the following:

- On 1 April 2014 a Convertible Note is issued to the holder for $1,000 with an interest coupon set at the arm's length interest rate of 8.5%. The Convertible Note will convert to a 45% interest in a partnership on 31 March 2019.
- The conversion to a partnership interest will be effected by way of a mandatory set off. The holder's obligation to make its capital contribution will be satisfied by setting off that obligation against the issuer's obligation to repay the Convertible Note.
- Coupon payments accrue monthly, in arrears and are compounding. Interest will be paid to the holder on the first partnership distribution date.
- On the date of issue, the limited partners have agreed that the market value of a 45% partnership interest on 31 March 2019 is $1,000.00.
- The parties use a 31 March balance date and apply Determination G1A on a 365 day basis when apportioning daily income and expenditure.
- The annual sum of Coupon Interest Payments is as follows:

31 March 2015	88.39
31 March 2016	96.20
31 March 2017	104.71
31 March 2018	113.96
31 March 2019	124.04
	527.30

The amounts that must be spread under the financial arrangements rules are the Coupon Interest Payments which shall be apportioned using the method outlined in *Determination G1A: Apportionment of Daily Income and Expenditure*.

This Determination is signed by me on the 25th day of July 2014.

Howard Davis
Director (Taxpayer Rulings)

SPECIAL DETERMINATION S28: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO THE D&C PHASE IN A PUBLIC-PRIVATE PARTNERSHIP

This determination may be cited as Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership.

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

1. This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of operation and maintenance services in respect of the Facility by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership. The limited partners in the Holding Partnership are Limited Partner A, Limited Partner B and Limited Partner C. This determination does not apply to Limited Partner C.
2. The Project Agreement comprises three basic components:
    - A design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;
    - A Facility Lease in which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and
    - An operations and maintenance phase (the O&M Phase) under which the Partnership will provide operation and maintenance services to the Crown over a 25 year term in consideration for monthly payments (the Unitary Charge).
3. The Partnership will enter into:
    - A Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and
    - An Operation and Maintenance Contract (the O&M Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for monthly payments.
4. The Partnership will raise external debt from a range of third party financiers (the Bank Debt). Limited Partner C will provide a term debt facility (the Term Debt Facility) to the Partnership to supplement the Bank Debt.
5. The Holding Partnership will receive funding from Limited Partner C during the D&C Phase in the form of a convertible debt instrument (the Convertible Note). Limited Partners A and B will provide investment support during the D&C Phase in the form of a letter of credit to the external lenders.
6. The Partnership will enter into Interest Rate Swaps in respect of the Bank Debt.
7. The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Bank Debt, Term Debt Facility and Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement.
8. *Special Determination S27: Convertible Notes in respect of a limited partnership* applies to the Convertible Notes. *Special Determination S29: Application of the financial arrangements rules to a public-private partnership* applies to arrangements in the wider financial arrangement, excluding the D&C Payment.
9. This determination prescribes the portion of the D&C Payment treated as income under the financial arrangement rules (the Interest Component) and the method for spreading that income.

2. Reference

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

3. Scope of determination

1. This determination applies to the Partnership in respect of the Project (which is set out in detail in Private Rulings BR Prv 14/31 and BR Prv 14/32 issued on 25 July 2014), including the D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation.

2. This determination is made subject to the following conditions:
   - The design and construction costs of the Facility are agreed between the Partnership and the Crown on an arm's length basis and set out in the Base Case under the Project Agreement as referenced to in the definition of "Design and Construction Payment" in section 1.1 of the Project Agreement.
   - Limited Partner A and Limited Partner B use IFRSs to prepare financial statements and to report for financial arrangements.
   - The continued application of private rulings BR Prv 14/31 and BR Prv 14/32 issued on 25 July 2014.
   - The executed documentation not being materially different from the final documentation that was provided to Inland Revenue on 23 July 2014 to the extent that it impacts on the scope of the determination or the application of the financial arrangement rules to the Applicants and the scope of the determination.

4. Principle

1. During the D&C Phase of the Project Agreement, the Partnership will receive consideration from the Crown (in the form of the D&C Payment) and will in turn provide consideration to the Crown (in the form of the completion of the TG Project and the transfer of its rights, set out in clause 11.2(c) of the Project Agreement, in the Facility). The D&C Phase of the Project Agreement is a "financial arrangement" under s EW 3 and an "agreement for the sale and purchase of property or services" under s YA 1.
2. The Partnership and the Crown have agreed that the D&C Payment includes capitalised interest (clause 12.5(c) of the Project Agreement). The Interest Component of the D&C Payment will be income under the financial arrangements rules under subpart EW.
3. During the D&C Phase the Partnership has variable expenditure commitments which will accrue. The capitalised interest component of the D&C Payment is intended to offset the expected funding costs incurred in relation to these commitments.
4. The Interest Component is calculated with reference to expected funding costs. No adjustment is made for variances between actual and expected costs as the D&C Payment, including capitalised interest, is agreed in advance.
5. The Interest Component needs to be spread over the term of the D&C Phase.

5. Interpretation

1. In this determination, unless the context otherwise requires:
   - "IFRS" means International Financial Reporting Standards as defined in s YA 1.
   - Capitalised terms have the same meaning as set out in the Project Agreement.
   - All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.

6. Method

Calculation of Interest Component

1. The value of the completion of the TG Project and transfer of the Partnership's rights to the Crown, set out in clause 11.2(c) of the Project Agreement, is the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement.
2. The D&C Payment less the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement, is the Interest Component that is income under the financial arrangements rules.
3. BR Prv 14/31 rules on the portion to the D&C Payment that is not income under the financial arrangements rules, and is not considered in this determination.

Spreading of Interest Component

1. The method for determining the amount of income that is to be allocated to each income year is as follows:
   a) The expected design and construction costs of the facility (excluding fitout) as set out in the Base Case are treated as having been incurred at the beginning of each of the six income years (the Annual Expenditure). No adjustment will be made to the Annual Expenditure in any income year to reflect actual expenditure in that year.
   b) The interest allocated to each income year is then calculated in accordance with the following formula:

      $$Interest = OB \times R$$

      Where:

      OB is the sum of the Annual Expenditure for that income year, plus the Annual Expenditure and interest attributable to any previous income year.

      R is the internal rate of return (based on annual rests) calculated using the notional cash flows in paragraph (a) above at the beginning of each income year as outflows, and the D&C Payment at the end of the D&C Phase as the only inflow.

7. Example

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

The Partnership and the Crown agree to the D&C Payment under the Base Case sheet that the D&C Payment equals $1,200,000.

The Base Case sets out that the agreed design and construction costs of the TG Project (excluding Fitout) are to be $970,748.

The value of the "completion of the TG Project and the transfer of the rights set out in clause 11.2(c)" of the Project Agreement, as set out in Clause 12.3 of the Project Agreement, is equal to $970,748.

The Interest Component of the D&C Payment is $229,252 by implication of the valuation under this determination.

Limited Partner A and Limited Partner B will spread the Interest Component over the term of the D&C Phase of the Project Agreement, as follows.

The Annual Expenditure incurred and treated as having been incurred at the beginning of the relevant income year is as follows:

Year	Actual D&C costs
1	($190,494)
2	($296,488)
3	($245,464)
4	($173,759)
5	($62,168)
6	($2,376)
D&C Payment	$1,200,000
	($970,748)

Based on receipt of the $1,200,000 D&C Payment in Year 6 the Project has an internal rate of return of 4.9171%.

The Interest Component is therefore spread as follows:

Year	Actual D&C costs	Cumulative	Interest income
1	($190,494)	($190,494)	$9,367
2	($296,488)	($496,348)	$24,406
3	($245,464)	($766,218)	$37,675
4	($173,759)	($977,652)	$48,072
5	($62,168)	($1,087,892)	$53,492
6	($2,376)	($1,143,761)	$56,239
		$1,200,000	
	($970,748)		**$229,252**

This Determination is signed by me on the 25th day of July 2014.

Howard Davis
Director (Taxpayer Rulings)

SPECIAL DETERMINATION S29: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO A PUBLIC-PRIVATE PARTNERSHIP

This determination may be cited as Special Determination S29: Application of the financial arrangements rules to a public-private partnership.

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

1. This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of operation and maintenance services in respect of the Facility by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership. The limited partners in the Holding Partnership are Limited Partner A, Limited Partner B and Limited Partner C. This determination does not apply to Limited Partner C.
2. The Project Agreement comprises three basic components:
   - A design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;
   - A Facility Lease in which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and
   - An operations and maintenance phase (the O&M Phase) under which the Partnership will provide operation and maintenance services to the Crown over a 25 year term in consideration for monthly payments (the Unitary Charge).
3. The Partnership will enter into:
   - A Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and
   - An Operation and Maintenance Contract (the O&M Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for monthly payments.
4. The Partnership will raise external debt from a range of third party financiers (the Bank Debt). Limited Partner C will provide a term debt facility (the Term Debt Facility) to the Partnership to supplement the Bank Debt.
5. The Holding Partnership will receive funding from Limited Partner C during the D&C Phase in the form of a convertible debt instrument (the Convertible Note).
6. The Partnership will enter into Interest Rate Swaps in respect of the Bank Debt.
7. The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Bank Debt, Term Debt Facility and Interest Rate Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement.
8. *Special Determination S27: Convertible Notes in respect of a limited partnership interest* applies to the Convertible Notes. *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership* applies to the D&C Payment under the D&C Phase.
9. This determination prescribes:
   - The amount of consideration that is solely attributable to the Facility Lease;
   - How the financial arrangements rules apply to the O&M Phase of the Project Agreement, the Construction Agreement and the O&M Contract;
   - The method for spreading the payments made under the Bank Debt, Term Debt Facility and Interest Rate Swaps.

2. Reference

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

3. Scope of determination

1. This determination applies to the Partnership in respect of the Project (which is set out in detail in Private Rulings BR Prv 14/31 and BR Prv 14/32 issued on 25 July 2014), including the following arrangements:
   - The D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation (which is the subject of *Special Determination S28: Application of*

the financial arrangements rules to the D&C Phase of a public-private partnership);

- The O&M Phase of the Project Agreement, under which the Partnership will provide on-going operation and maintenance services for 25 years to the Crown in consideration for monthly payments;
- The Facility Lease, under which the Partnership will lease the Facility from the Crown for 25 years and make the Rental Prepayment to the Crown. The Rental Prepayment will be equal to and will offset the D&C Payment;
- A Construction Agreement with the Contractor, under which the Contractor will design and construct the Facility in consideration for payments under the Construction Agreement;
- An O&M Contract with the Service Provider, under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for payments under the O&M Contract;
- Bank Debt, under which the Partnership will borrow an agreed sum from external lenders for a term of 7 years from financial close of the Project (Financial Close). The Bank Debt will be a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date. It is expected that the Bank Debt will be refinanced within 7 years of Financial Close, and every 7 years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this Determination), the Bank Debt (and any subsequent re-financings) will initially be recognised at fair value plus integral fees, and subsequently measured using the amortised cost using the effective interest method (regardless of whether or not hedge accounting is applied), and will not be treated as a hedge of another financial arrangement;
- Interest Rate Swaps, under which the Partnership will pay a fixed rate of interest to the swap counterparties, and receive a floating rate in return;
- Term Debt Facility under which the Partnership will borrow an agreed sum from Limited Partner C during the D&C Phase for a market rate of interest that converts to an amortising senior tranche on the Conversion Date. The Term Debt Facility will be recognised under IFRS as a financial liability and initially recorded at fair value plus integral fees. Subsequent measurement will be at amortised cost using the effective interest method;
- Convertible Note issued by Holding Partnership to Limited Partner C for the duration of the D&C Phase. On a single or several nominated dates during the D&C Phase, the Convertible Note will convert (by way of mandatory set off) into a partnership interest in Holding Partnership for Limited Partner C (which is the subject of *Special Determination S27: Convertible Notes in respect of a limited partnership interest*).

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

- Limited Partner A and Limited Partner B use IFRS to prepare financial statements.
- Limited Partner A and Limited Partner B will recognise income derived from the Crown during the D&C Phase of the Project Agreement and the O&M Phase of the Project Agreement, and will deduct expenditure incurred in relation to the Facility Lease, Construction Agreement and O&M Contract, in each case, under the relevant provisions of the Income Tax Act 2007 (outside of the financial arrangement rules).
- Limited Partner A and Limited Partner B do not use the fair value method for the Bank Debt or Term Debt Facility if the Bank Debt or Term Debt Facility is treated as a hedge of another financial arrangement under IFRS and uses for the other financial arrangement a method that is neither the IFRS financial reporting method nor the method required under *Determination G29: Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure*.
- Limited Partner A and Limited Partner B will recognise income and expenditure in respect of the Convertible Note in the manner prescribed by *Special Determination S27: Convertible Notes in respect of a limited partnership interest*.
- Limited Partner A and Limited Partner B will recognise income in respect of the D&C Payment in the manner prescribed by *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership*.
- The continued application of Private Rulings BR Prv 14/31 and BR Prv 14/32 issued on 25 July 2014.
- The executed documentation not being materially different from the final documentation that was provided to Inland Revenue on 23 July 2014 to the extent that it impacts on the scope of the determination or the application of the financial arrangement rules to the Applicants and the scope of the determination.

4. Principle

1. The Facility Lease is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(2) to (16) is not an amount that is taken into account under the financial arrangement rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Facility Lease that are not taken into account under the financial arrangement rules.
2. The O&M Phase, Construction Agreement and O&M Contract are "short-term agreements for sale and purchase" as defined in s YA 1, and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement, is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Partnership in respect of the O&M Phase, Construction Agreement and O&M Contract are required to be spread under the financial arrangements rules.
3. The D&C Phase, Bank Debt, Interest Rate Swaps and Term Debt Facility are "financial arrangements" under s EW 3. This determination specifies that the payments made to or by Limited Partner A and Limited Partner B, in proportion to their share in Holding Partnership, under the Bank Debt, Interest Rate Swaps, and Term Debt Facility must be spread under the financial arrangements rules in accordance with this determination.
4. This determination does not deal with the treatment of the D&C Payment or the Convertible Note which are subject to separate determinations (*Special Determination S27: Convertible Notes in respect of a limited partnership interest* and *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership*).

5. Interpretation

1. In this determination, unless the context otherwise requires:
   - "IFRS" means International Financial Reporting Standards as defined in s YA 1.
   - All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.

6. Method

1. The Rental Prepayment paid in respect of the Facility Lease, and the property interest granted to the Partnership under the Facility Lease, are solely attributable to the Facility Lease and are not taken into account under the financial arrangement rules.
2. Limited Partner A and Limited Partner B are not required to spread any amounts under the financial arrangements rules in respect of the:
   - O&M Phase of the Project Agreement;
   - Construction Agreement;
   - O&M Contract.
3. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Bank Debt and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.
4. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of any subsequent refinancing of the Bank Debt over the term of the relevant refinancing, provided that the terms of any such refinancing are materially similar to the terms of the Bank Debt. This determination paragraph does not affect Partner A or Partner B's obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.
5. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Term Debt Facility. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.
6. The expected value method in s EW 15F may be used to allocate income and expenditure (other than "non-contingent fees" as defined in s YA 1) over the term of the Interest Rate Swaps provided that the swaps are not treated as a hedge of other financial arrangements for which the "fair value method" is used. None of the mandatory spreading methods in s EW 15H or s EW 15I apply to the Interest Rate Swaps.
7. This determination does not affect Limited Partner A or Limited Partner B's obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps.

7. Example

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

This example is based on the following parameters:

Commencement of D&C Phase	1 July 2014
Completion of D&C Phase	30 June 2019
Completion of O&M Phase	30 June 2044
D&C Payment from the Crown	$1,000
Aggregate payments to the Contractor	($850)
Facility Lease prepayment	($1,000)
Monthly payments from the Crown during the O&M Phase	$30
Monthly payments to the Service Provider	($15)
Annual interest on the Bank Debt	($85)
Annual interest on the Term Debt Facility	($7)
Annual interest (and inflation adjustment) on the Convertible Note	($15)
Annual net payments in respect of the Interest Rate Swaps	($7)

The Partnership is not required to spread any amounts under the financial arrangements rules in respect of the Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract.

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

- Interest on the Bank Debt calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Interest on the Term Debt Facility calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F;
- Amounts in respect of the Convertible Note as specified in *Special Determination S27: Convertible Notes in respect of a limited partnership interest;*
- Amounts in respect of the D&C Payment as specified in *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership.*

This Determination is signed by me on the 25th day of July 2014.

Howard Davis
Director (Taxpayer Rulings)

GENERAL DEPRECIATION DETERMINATION DEP89: BENCH-TOP PIZZA OVENS AND MICROWAVE OVENS (COMMERCIAL)

Note to Determination DEP89

The Commissioner has set general depreciation rates for bench-top pizza ovens and microwave ovens (commercial) by adding new asset classes to the "Hotels, motels, restaurants, cafes, taverns and takeaway bars" and "Shops" industry categories.

As loaned or hired assets tend to be handled and transported frequently and are not as well maintained as owned assets, a further asset class is provided for "pizza ovens (bench-top, for long term loan or hire)", with a lesser estimated useful life. **Note**: Long-term loan or hire applies to a period greater than one month.

Commercial microwave ovens are very common in commercial kitchens and also in shops. These ovens are usually of a similar size to domestic microwave ovens but are constructed of better quality materials, and are not as large or long lasting as industrial microwave ovens used in food processing factories. A new asset class of "microwave ovens (commercial)" has been provided.

DETERMINATION DEP89: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER DEP89

1. Application

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

This determination applies from the 2014 and subsequent income years.

2. Determination

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

- adding into the "Hotels, motels, restaurants, cafes, taverns and takeaway bars" and "Shops" industry categories, new asset classes, estimated useful lives, and diminishing value and straight line depreciation rates as listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Pizza ovens (bench-top)	6.66	30	21
Pizza ovens (bench-top, for long-term loan or hire)	5	40	30
Microwave ovens (commercial)	8	25	17.5

3. Interpretation

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

This determination is signed on the 18th day of August 2014.

Rob Wells
LTS Manager, Technical Standards

QUESTIONS WE'VE BEEN ASKED

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

QB 14/07: TAX ADMINISTRATION ACT 1994 – PROSCRIBED QUESTIONS

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

This Question We've Been Asked applies in respect of ss 91E(4)(a) and 91F(4)(a).

Question

1. We have been asked whether the Commissioner may include a statement relating to a "proscribed question" in a private or product ruling.

Answer

2. Yes. Including a statement relating to a "proscribed question" (such as a reference to a person's intention) in the description of the Arrangement, or as an assumption or a condition, in a private or product ruling will not breach s 91E(4)(a) or s 91F(4)(a).

Explanation

3. Section 91E(4)(a) provides that the Commissioner may not make a private ruling if:

    (a) the application for the ruling would require the Commissioner to determine a proscribed question …

4. Section 91F(4)(a) contains an equivalent provision in relation to product rulings.
5. The term "proscribed question" is defined in s 3:

    proscribed question means—

    (a) whether a fact is correct or exists:

    (b) what is a person's purpose or intention, for the purpose of any provision of the Income Tax Act 2007 that expressly refers to a person's purpose or intention:

    (c) what is the value of a thing:

    (d) what is commercially acceptable practice, for the purposes of any provision of that Act that expressly refers to commercially acceptable practice

6. We have been asked whether including a statement in a description of the Arrangement, or as an assumption or a condition, in a ruling could be "determining" a proscribed question for the purposes of s 91E(4)(a).

Assumptions and conditions

7. The situation in respect of assumptions and conditions about proscribed questions in a ruling is clear.
8. Sections 91EF(3) and 91FF(3) provide that the Commissioner may make assumptions about the answer to a proscribed question, and making those assumptions is not treated as determining the proscribed question for the purposes of s 91E(4)(a).
9. Similarly, ss 91EH(1B) and 91FH(1B) provide that the Commissioner may stipulate conditions about the answer to a proscribed question, and stipulating those conditions is treated as not determining the proscribed question for the purposes of s 91E(4)(a).
10. The legislation is clear that the Commissioner may include an assumption or a condition in a private or product ruling that relates to a proscribed question, such as the value of a thing or a person's intention. If the Commissioner includes an assumption or a condition in a ruling relating to a proscribed question, the applicant may be able to seek a Factual Review of the condition or assumption (for more information on Factual Reviews, go to **www.ird.govt.nz** (keyword: factual review)).

Description of the Arrangement

11. There is no equivalent provision in respect of the answer to a proscribed question being included in the description of the Arrangement in a ruling. This omission can be interpreted in two ways. On the one hand, it could suggest that a similar outcome was intended in respect of the description of the Arrangement, but that Parliament thought clarification was necessary only in respect of conditions and assumptions. On the other hand, it could suggest that Parliament did not intend that the Commissioner include the answer to a proscribed question in the description of the Arrangement and that Parliament deliberately or implicitly contrasted those positions in the legislation.

12. With this in mind, to answer the question we must consider the meaning of the term "determine". The *Concise Oxford English Dictionary* (12th edition, 2011, Oxford University Press) contains the following definitions of the term "determine":

    Determine v. 1 cause to occur in a particular way; be the decisive factor in. **2** firmly decide: *she determined to tackle Stephen the next day*. **3** ascertain or establish by research or calculation. **4** Mathematics specify the value, position, or form of (a mathematical or geometrical object) uniquely. **5** Law, archaic bring or come to an end

13. The term "determine", therefore, has a variety of meanings, but the most relevant ones relate to something being decided or ascertained.

14. This is consistent with the second definition of "determine" in *Osborn's Concise Law Dictionary* (10th edition, 2009, Thomson, Sweet and Maxwell, edited by Mick Woodley), which states:

    Determine. (1) To come to an end; (2) To decide an issue or appeal.

15. Several cases have considered the meaning of the term "determine".

16. In some of those cases, such as *Town v Stevens* (1899) 17 NZLR 828, the courts have found that the term "determined" means "ended". This is meaning five from the *Concise Oxford English Dictionary* (quoted above). However, this interpretation cannot be relevant in the present situation, because the Commissioner will not be "ending" a proscribed question. Such an interpretation would be nonsensical in this context.

17. The Supreme Court of Victoria in *City of Heidelberg v McPherson* [1964] VicRp 102, [1964] VR 783 considered whether a resolution that the council of the City of Heidelberg is "of the opinion that the following works are necessary", meant that the council had "determined" that the works were necessary. O'Bryan J stated, at 785:

    Now it is quite clear that in this particular matter the council is not called upon to determine any matter inter partes, it is not making a decision between two people as to who is in the right or who is in the wrong or who has rights or powers against the other: **it is doing no more than making up its mind whether certain works are necessary;** it is acting, in other words, in a governmental or executive capacity. I would have thought that when a council says, by resolution through its councillors, that "it is of opinion that so and so", it means quite clearly that **it has made up its mind, or decided, or determined, whichever word you like to use,** that these works are necessary. I do not think that this fine distinction which is made by Mr. McHugh gives a correct meaning to the words in this section. **The word "determines" in this context means no more than decides or forms the opinion.**

    [Emphasis added]

18. The English Court of Appeal reached a similar conclusion in *Muir v Inland Revenue Commissioners* [1966] 3 All ER 38, where Win J stated, at 48:

    Whilst the matter is not really relevant if the view which I have already expressed be correct, I nevertheless desire to say that I am of the firm opinion that the word "determination" there used cannot be given the meaning, which I understood to be suggested by the submission, of "assessment". **In my opinion the context in which the word is used, and, indeed, used several times in the section, with or without the corresponding verb "determine", is far too strong to permit of its being understood as meaning anything but a decision on a point of law declared by the commissioners.**

    …

    It is plain that there the words "determined" and "determination" are equivalent to: decided and decision, and are quite incapable of being understood to mean an assessment or the amount stated in an assessment …

    [Emphasis added]

19. More recently, the English Court of Appeal (Criminal Division) in *Young v R* [2004] 2 All ER 63 considered whether a confiscation order had been "determined" within six months, as required by the relevant legislative provision. May LJ, delivering the decision of the court, stated, at [56]:

    We consider on reflection that **the words "determining" and "determination" connote the end of the process, that which the court eventually decides.** A substantive start to a hearing within the six month period which is adjourned beyond that period does not achieve a determination within the six month period.

    [Emphasis added]

20. Based on the above cases, and consistent with the dictionary definitions, the Commissioner considers that the word "determine" in s 91E(4)(a) must mean "decide". This interpretation seems appropriate in the context of the rulings regime, because a ruling gives the Commissioner's decision on the application of tax laws to an Arrangement. The purpose of s 91E(4)(a) seems to be to prevent the Commissioner from being required to decide whether certain factual matters are correct.

21. Simply including a statement in the description of the Arrangement of a matter that has been advised to the Commissioner as part of an application for a binding ruling does not involve a decision being made on whether the statement is correct. Therefore, simply including a statement relating to a proscribed question (such as a reference to a person's intention) in the description of the Arrangement cannot breach s 91E(4)(a).
22. In this regard, ss 91EJ and 91FK specifically contemplate the Commissioner relying on facts provided by the applicant for a ruling. Subsection (1) of those sections provides that the information supplied to the Commissioner is the factual basis on which the Commissioner makes a private or product ruling. Subsection (2)(a) of those sections provides that the Commissioner may inquire into the correctness of those facts before a ruling is made, but is not required to do so. Similarly, under ss 91EB(2)(a) and 91FB(2)(a), if the arrangement entered into differs materially from the arrangement described in the ruling (based on the facts provided by the applicant), the ruling does not apply.

References

Subject references
Proscribed questions
Legislative references
Tax Administration Act 1994 – ss 3 (definition of "proscribed question"), 91E(4)(a), 91EF(3), 91EH(1B), 91EJ, 91F(4)(a), 91FF(3), 91FH(1B), 91FK
Case references
City of Heidelberg v McPherson [1964] VicRp 102; [1964] VR 783
Muir v Inland Revenue Commissioners [1966] 3 All ER 38
Town v Stevens (1899) 17 NZLR 828
Young v R [2004] 2 All ER 63
Other references
Concise Oxford English Dictionary (12th edition, 2011, Oxford University Press)
Osborn's Concise Law Dictionary (10th edition, 2009, Thomson, Sweet and Maxwell, edited by Mick Woodley)

QB 14/08: INCOME TAX – COSTS OF DEMOLISHING AN EXISTING BUILDING ON A BUILDING SITE

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

This Question We've Been Asked is about ss DA 1, DA 2, EE 6, EE 7, EE 31(2), EE 31(3), EE 44, EE 45(1), EE 45(2), EE 48, EE 61(3B) and YA 1, definition of "dispose", para (f). This item applies where the building demolished and the replacement building are used in deriving assessable or excluded income, or in the course of carrying on a business to derive such income, but not where either building is a revenue account asset.

This item updates and replaces the item "How costs of clearing a site are treated for tax purposes", published in *Public Information Bulletin* No 45, p 9 (April/May 1968). That item explains that no income tax deduction is permitted for the costs of demolishing a building to prepare a site for construction of a new building. The item says that those costs are part of the cost of the site, are capital, and cannot be included in depreciation claimed for the new building. The current relevance of this information was identified during an ongoing review of content published in *Public Information Bulletins* and *Tax Information Bulletins* before 1996. The *Public Information Bulletin* review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013).

Question

1. When erecting a new building on a site are the costs of demolishing an existing building on the site included as part of the cost of the new building and are the costs deductible for income tax purposes?

Answer

2. The costs of demolishing the existing building are not part of the cost of the new building and are not deductible for income tax purposes as they are of a capital nature. Instead, the costs are taken into account under the depreciation rules in determining the consideration received by the taxpayer from the disposal of the demolished building. Different rules apply for temporary buildings.

Explanation

3. Demolition costs are expenditure incurred by a person in removing a building from a site. Where a person removes a building themselves, rather than paying a demolition expert to do the whole job, examples of demolition costs include wages paid to staff who carry out the work, the cost of hiring equipment to carry out the work, the cost of carting demolition material from the site and tip fees for dumping that material.
4. A person is entitled to a deduction for expenditure incurred in the course of deriving their assessable or excluded income, or incurred in the course of carrying on a business for the purpose of deriving such income (s DA 1(1)) but only if, relevantly, the expenditure is not of a capital nature (ss DA 2(1) and DA 2(7)).
5. *CIR v McKenzies NZ Ltd* (1988) 10 NZTC 5,233 (CA) contains a discussion of the general principles for determining whether expenditure has a capital nature. In discussing *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1965] 3 All ER 209 (PC) the Court of Appeal in *McKenzies* said at 5,236:

   > Amongst the factors weighed by the Judicial Committee in *BP Australia* were: (a) the need or occasion which called for the expenditure; (b) whether the payments were made from fixed or circulating capital; (c) whether the payments were of a once and for all nature producing assets or advantages which were an enduring benefit; (d) how the payment would be treated on ordinary principles of commercial accounting; and (e) whether the payments were expended on the business structure of the taxpayer or whether they were part of the process by which income was earned.

6. Subsequently, in *CIR v Lyttelton Port Company Limited* (1997) 18 NZTC 13,273 (CA), the Court of Appeal considered whether a port company was entitled to a deduction for building demolition costs. The company did not want the buildings and had been forced to acquire them as part of a port restructure plan. The court noted there were no New Zealand cases on demolition costs and referred to the Australian cases of *Commissioner of Taxation of the Commonwealth of Australia v Broken Hill Pty Co Ltd* (1967) 120 CLR 240 (HCA) and *Mount Isa Mines Ltd v FCT* 92 ATC 4755 (HCA). The Court of Appeal considered the facts of the case before it were very similar to those in the *Mount Isa* case. The Court of Appeal noted that the court in *Mount Isa* relied on *Tucker v Granada Motorway Services Ltd* [1979] 2 All ER 801 (HL). The Court of Appeal, at 13,276, quoted the following from the speech of Lord Wilberforce in *Tucker*:

   > I think that the key to the present case is to be found in those cases which have sought to identify an asset. In them it seems reasonably logical to start with the assumption that money spent on the acquisition of the asset should be regarded as capital expenditure.

> Extensions from this are, first, to regard money spent on getting rid of a disadvantageous asset as capital expenditure and, secondly, to regard money spent on improving the asset, or making it more advantageous, as capital expenditure.

7. The Court of Appeal then went on to say that:

   > … the identifiable asset test is one which has relevance to the present case. The respondent obtained a long-term benefit as the result of clearing the area of an unwanted building and improving the standard and extent of the wharf area. This benefit can only be characterised as an improvement in a capital asset.

   and later, at 13,276–13,277, that:

   > Effectively, this was the disposition of a disadvantageous asset. Moreover, the demolition improved the respondent's capital asset by providing an upgraded and additional uncluttered wharf area. … The effect of the demolition was to enhance the assets deployed by the respondent in the production of revenue.

8. Accordingly, where a building being demolished is a capital asset, the demolition expenditure will be capital expenditure and not deductible under s DA 1(1). Expenses that are not otherwise deductible may, in some cases, be taken into account under the depreciation rules.

9. Buildings are depreciable property (ss EE 6 and EE 7). For buildings with an estimated useful life of 50 years or more, the depreciation rate is 0% (ss EE 31(2)(d), EE 31(3)(c), EE 61(3B) and EZ 13(2)(c)).

10. Section EE 48 applies where a person has consideration from the disposal of depreciable property (s EE 44). Disposal of an asset includes destroying it (s YA 1, para (f) of definition of "dispose"). Section EE 45(1) provides that the consideration for disposal is the amount the person derives (excluding GST where they are a registered person):

    > minus the amount (the **disposal cost**) that they incur in deriving the amount, to the extent to which the disposal cost—
    >
    > (a) is not allowed as a deduction to the person, other than as a deduction for an amount of depreciation loss; and
    >
    > (b) is not counted in "the amount that a person derives".

11. The consideration can be zero or a negative amount (s EE 45(2)). Where the building (or its neighbourhood) is damaged rendering the building useless for deriving income and it is demolished, the consideration consists of any insurance, indemnity or compensation received plus any consideration received for the disposal (s EE 45(8)).

12. Section EE 45 applies to the demolition costs as they are costs of disposing of a depreciable asset, the building, and the taxpayer is not allowed a deduction for the costs because of their capital nature. This means that, in calculating the consideration from the disposal of a building, the costs of the disposal are deducted from any amount a person derives from the disposal. For example, if it costs $10,000 to demolish a building and the owner sells various items from the demolished building for a total of $11,000, then the consideration from the disposal of the building will be $1,000 (ie, $11,000 – $10,000). On the other hand, if the only proceeds received are from the sale of some doors for $900, the consideration for the disposal of the building will be –$9,100 (ie, $900 – $10,000).

13. Where consideration from the disposal of depreciable property is more than the property's adjusted tax value, a taxpayer derives assessable income. However, this is limited to the total amount of depreciation previously claimed for the asset (s EE 48(1)).

14. Generally, where the consideration received on disposal of a depreciable asset is less than its adjusted tax value, the taxpayer will have a depreciation loss (s EE 48(2)). However, under s EE 48(3), no depreciation loss on disposal can arise in respect of a building unless:

    - the building was rendered useless for the purpose of deriving income;
    - the building was demolished as a result of damage to the building or the building's neighbourhood; and
    - the damage was caused by a natural event not under the control of the taxpayer, their agent or associated person and not as a result of a failure to act by the taxpayer, their agent or an associated person.

15. An example of where demolition costs may be taken into account in calculating a depreciation loss is where a building is demolished after being rendered useless for deriving income as a result of a cyclone or an earthquake. For information on changes to the depreciation and other tax provisions introduced in response to the Canterbury earthquakes see *Tax Information Bulletin* Vol 24, No 10 (December 2012): 23 and Vol 23, No 8 (October 2011): 65.

16. Where a building is sold cheaply for removal, rather than being demolished, any loss on that sale would also be on capital account. No deduction would be allowed for that loss because of the application of s EE 48(3).

17. Where the building demolished is a temporary building as defined in s YA 1, a person will be allowed a deduction for a loss that they incur under s DB 20. This section overrides the capital limitation.

References

Subject references
Capital expenditure – Consideration from disposal of depreciable property; Demolition costs
Legislative references
Income Tax Act 2007 – ss DA 1, DA 2, EE 6, EE 7, EE 31(2), EE 31(3), EE 44, EE 45(1), EE 45(2), EE 48, EE 61(3B) and YA 1 , definition of "dispose", para (f)
Case references
BP Australia Limited v Commissioner of Taxation of the Commonwealth of Australia [1965] 3 All ER 209
CIR v McKenzies NZ Ltd (1988) 10 NZTC 5,233
CIR v Lyttelton Port Company Limited (1997) 18 NZTC 13,273
Commissioner of Taxation of the Commonwealth of Australia v Broken Hill Pty Co Ltd (1967) 120 CLR 240
Mount Isa Mines Ltd v FCT 92 ATC 4755
Tucker v Granada Motorway Services Ltd [1979] 2 All ER 801

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.

SUFFICIENT CONNECTION – SECTION DA 1 OF THE INCOME TAX ACT 2004

Case	Ean Innes Brown v Commissioner of Inland Revenue [2014] NZHC 1599
Decision date	9 July 2014
Act(s)	Income Tax Act 2004, Tax Administration Act 1994
Keywords	Nexus, sufficient connection, income-earning process

Summary

The Commissioner of Inland Revenue ("the Commissioner") disallowed interest deductions claimed by the appellant, Ean Innes Brown, in the 2005 to 2007 income tax years. The Taxation Review Authority ("TRA") and now the High Court have upheld the Commissioner's assessments disallowing the interest deductions due to there being an insufficient connection between the deductions and the appellant's income-earning process.

Impact of decision

This decision confirms that interest can only be deducted where it is incurred by the person and that there must be a sufficient connection between the expense and the income-earning process for the nexus to be met.

Facts

The appellant, Ean Innes Brown, who practised as a chartered accountant, claimed interest deductions in the 2005, 2006 and 2007 income tax years. The Commissioner disallowed the deductions on the basis that the appellant did not incur the interest expenditure and that there was no sufficient nexus between the payments made by the appellant and the appellant's income-earning process. The Commissioner also imposed shortfall penalties in those income years for failure to take reasonable care. Those assessments were challenged before the TRA and the assessments were upheld.

Background

The appellant practised as a chartered accountant through a company ("Accounting"). The appellant, his wife, and his business partner were the three directors. A trust ("Trust") was settled by the appellant in 2000. His wife and business partner were the trustees. In 2000, the Trust borrowed $420,000 from the bank and on-lent this to Accounting, which used the funds to purchase an accountancy practice.

In 2004, Trust borrowed a further $250,000 from the bank and on-lent it to Accounting to acquire another accountancy practice. Accounting gave a guarantee of the Trust's indebtedness to the bank. The appellant and others also gave guarantees of the indebtedness to the bank. Over the relevant tax years, the appellant paid the bank the interest charged to the Trust on the loans, in total nearly $100,000.

Decision

Contractual obligation to reimburse

The appellant relied upon a minute of the trustees dated 14 April 2004 which recorded that "at the request of [the Bank] … it is agreed [the appellant] will pay the interest and principal payment on the two loans …". The Court found the appellant's evidence did not establish a legally enforceable obligation on the appellant to pay the interest.

The Court confirmed the finding and reasoning of the TRA that there was no definitive commitment on the appellant to make the interest payment.

Statutory or common law right of indemnity to reimburse

The appellant asserted an alternative argument that the Trust was liable to reimburse the appellant, either under sections 84 and 85 of the Judicature Act 1908 or under the common law right of indemnification, which arises when a guarantor makes a payment on behalf of the principal debtor.

The Court upheld the finding of the TRA that the appellant has no right to indemnity from the Trust for the interest paid. The Court noted that a prerequisite to the application of sections 84 and 85 of the Judicature Act is that the

person seeking to invoke the rights conferred is a "surety for the debt or duty of another", or "liable with another for any debt or duty".

The Court held that the appellant was not a guarantor of the Trust's indebtedness to the bank. Accordingly, the Court found that the appellant's claim to a right of indemnity from the Trust must fail.

Nexus

Counsel for the appellant proposed that in circumstances where a particular item of expenditure does not have any other nexus with the derivation of any other assessable income, the existence of a right to be reimbursed that item of expenditure by another is sufficient to make both the payment and the subsequent reimbursement part of the income-earning process. No authority was cited in support of this proposition.

As the Court found that there was no contractual, statutory or common law right of indemnity upon the Trust to repay the appellant, it was unnecessary for the Court to consider whether an expectation of reimbursement would meet the test in section DA 1 of the Income Tax Act 2004. The Court found that the interest in this case was not deductible.

Shortfall penalties

The Court upheld the TRA's finding that a shortfall penalty was payable because the taxpayer did not take reasonable care in taking the tax position he did when claiming a deduction for the amounts paid to the bank. This was largely due to the fact that the appellant is a partner in a firm of chartered accountants with expertise in the field. The TRA upheld the Commissioner's contention that the disputant had not acted as a reasonable person would have in the same circumstances (at [40]–[41] of *X Ltd (Chartered Accountant) v Commissioner of Inland Revenue* [2013] NZTRA 03).

The amount of penalty under section 141A of the Tax Administration Act 1994 ("TAA") for not taking reasonable care is 20 per cent of the resulting tax shortfall. The TRA held that this was reduced by 50 per cent under section 141FB(2) of the TAA.

NEXUS – SECTION DA 1 OF THE INCOME TAX ACT 2004

Case	P L Brown Farms Limited v Commissioner of Inland Revenue [2014] NZHC 1601
Decision date	9 July 2014
Act(s)	Income Tax Act 2004
Keywords	Nexus, sufficient connection, income-earning process

Summary

The Commissioner of Inland Revenue ("the Commissioner") disallowed interest deductions claimed by the appellant, P L Brown Farms Limited, in the 2006 and 2007 income tax years. The Taxation Review Authority ("TRA") and now the High Court have upheld the Commissioner's assessments disallowing the interest deductions due to there being an insufficient connection between the deductions and the appellant's income-earning process.

Impact of decision

Whether there is sufficient nexus, between the income-earning process and the deductions claimed by a taxpayer, pursuant to section DA 1 of the of the Income Tax Act 2004 ("the Act"), is determined by considering the legal arrangements entered into, not by considering what other arrangements the parties might have entered into.

Facts

The appellant, P L Brown Farms Limited ("Farms"), appealed the decision of the TRA upholding the assessments made by the Commissioner and dismissing the appellant's challenge to those assessments (*X Ltd (A Farming Company) v Commissioner of Inland Revenue* [2013] NZTRA 2).

Background

There are three relevant companies all ultimately owned by Mr and Mrs Brown. The Court, adopting the terms of the TRA, referred to the appellant as "Farms" and to the other two companies as "Sharemilking" and "Beef".

Farms (a qualifying company) borrowed from a bank on commercial terms and on-lent the borrowed funds to Sharemilking and Beef. One of the terms of this on-lending was that interest would be payable on demand, but in fact no interest was demanded from or paid by either Sharemilking or Beef.

The money was used by Sharemilking and Beef to purchase land now leased to Farms. The land purchase by Sharemilking included the purchase of shares in Fonterra.

Farms claimed deductions in the 2006 and 2007 income years for interest paid to the bank on the money borrowed and on-lent to Sharemilking and Beef. The Commissioner disallowed the deductions on the basis that the expenditure did not satisfy the general permission in section DA 1 of the Act, under which a deduction is allowed for expenditure incurred in deriving assessable income.

Decision

Nexus

The appellant submitted that there was a nexus between the interest paid and its assessable income, because the borrowed money on which the interest was paid was used to acquire land that Farms used to carry on its farming business. The Court noted that had this been the case, there would have been an indisputable nexus between the interest expenditure claimed and the income-earning process carried out by Farms. However, the Court found that the land was actually purchased by Sharemilking and Beef and leased to Farms.

The Court noted that the arrangements actually entered into needed to be analysed to determine whether the arrangements established a nexus. The Court found that there was no evidence of any agreement between Farms and either Sharemilking or Beef that made the granting of the leases conditional on receipt by Sharemilking or Beef from Farms of the funds borrowed by Farms.

The Court also held that there was no evidence of any contract or other arrangement between Farms on one hand, and Sharemilking and Beef respectively on the other, to create a nexus between the borrowing and the acquisition of the land by Farms.

The Court held that, on the evidence, the ultimate controllers of all three companies had the ability to achieve, and did achieve, the outcome that the borrowed money was used to buy land which was then leased to Farms. Accordingly, the Court held that this was not a nexus in terms of section DA 1 of the Act.

Barter transaction

The appellant asserted that it received a reduced rental in exchange for interest-free loans and therefore a barter transaction existed. The Court was not satisfied, on the evidence, that there was any barter arrangement.

Fonterra shares

The appellant submitted that there is a nexus between the interest payments and the derivation of income because the funds borrowed by Farms were used in part by Sharemilking to purchase the Fonterra shares under which the milk produced by Farms was sold. The Court found that the money borrowed was not used by Farms to acquire the shares—the shares were acquired by Sharemilking.

The Court also held that there was no evidence that Farms derived any income as a direct result of the acquisition of the Fonterra shares, nor was there any evidence of the extent to which Farms or Sharemilking derived dividend income from the Fonterra shares.

DUPLICATIVE CLAIMS STRUCK OUT, SECURITY FOR COSTS ORDERED

Case	Peter William Mawhinney as trustee of the Forest Trust v Commissioner of Inland Revenue [2014] NZHC 1554
Decision date	4 July 2014
Act(s)	Tax Administration Act 1994, Goods and Services Tax Act 1985
Keywords	Strike out, security for costs, duplication of process, abuse of process, vexatious

Summary

The Commissioner of Inland Revenue ("the Commissioner") successfully had a new cause of action struck out of the pleading because it was duplicative of other proceedings and an abuse of process. The Forest Trust was ordered to pay security for costs, as it had provided no evidence that it would be able to satisfy a costs order should it prove unsuccessful on its claims.

Impact of decision

The Court will entertain applications to strike pleadings (or portions of pleadings) when they are duplicative of other proceedings and/or an abuse of process.

Facts

This decision relates to interlocutory applications by the Commissioner to strike out parts of Mr Mawhinney's second amended statement of claim and for security for costs.

The underlying dispute involves a claim for a goods and services tax ("GST") refund of $67,011.65 relating to the Forest Trust's ("the Trust") purchase of a property for $600,000 in 2009, which the Commissioner had reassessed to nil under section 89C(eb) of the Tax Administration Act 1994 ("TAA").

On 12 July 2012, Mr Mawhinney filed a statement of claim of 88 pages, containing claims for 19 separate breaches of statutory duty; a claim for money had and received; and claims for six breaches of duty of care. Mr Mawhinney sought damages and/or compensation of $5,113,810.72.

In December 2013, Mr Mawhinney filed an amended statement of claim of 156 pages that included an additional cause of action alleging statutory entitlement and also purported to include an application for judicial review (despite the fact he had separately filed a proceeding for judicial review of the same decisions made by the Commissioner).

In February 2014, Mr Mawhinney filed his second amended statement of claim of 188 pages that included an additional, fourth cause of action purporting to be a challenge under Part 8A of the TAA.

The strike-out application concerned the new fourth cause of action.

Decision

The fourth cause of action was struck out and the application for security for costs in the sum of $40,000 was granted. The proceeding was to be stayed until that payment is lodged with the Court.

Strike-out application

The causes of action the Commissioner sought to have struck out were:

- a challenge to the Commissioner's reassessment of GST to nil for the period ended 31 July 2009;
- her decision that section 89C(eb) of the TAA provided grounds, function and power for the Commissioner to reassess the amount of GST to nil;
- her decision to accept that output tax was payable on the sale of the property at issue, while refusing the input tax refund on the same sale; and
- the Commissioner's failure to issue a challenge notice under section 89(P) of the TAA for the GST period ended 31 July 2009.

Mr Mawhinney argued that if he supplied information in support of GST refund claims, then his assessment must be accepted if the Commissioner takes no action within 15 working days after receipt of that information.

The Commissioner's position was that:

- she had retained refunds for seven GST periods for which she gave valid notices that she would withhold payment under section 46 of the Goods and Services Tax Act 1985;
- she offset refunds due for other tax periods; and
- for the GST period ended 31 July 2009, she validly amended the self-assessed amount of $67,011.65 to nil under section 89C(eb) of the TAA.

Mr Mawhinney contended that the disputes process under Part 4A of the TAA had concluded. He submitted that due to the Commissioner's failure to comply with time constraints, a GST refund is deemed payable by the Commissioner to the Trust.

However, the Court found that the disputes process was still underway, with the Trust's matter in the Taxation Review Authority ("TRA") stayed, pending the Court of Appeal's decision on Mr Mawhinney's appeal of the determination of the judicial review in the Commissioner's favour (by Cooper J on 23 December 2014). Thus, the fourth cause of action was a duplication of process.

The Court further held that if it was Mr Mawhinney's position that he retains access to challenge under Part 8A (as opposed to the Part 4A dispute access) then he faces a nearly insurmountable obstacle by virtue of what the Supreme Court said in the *Tannadyce Investments Limited v Commissioner of Inland Revenue* [2011] NZSC 158 ("*Tannadyce*") case:

> In summary therefore we would hold that disputable decisions (which include assessments) may not be challenged by way of judicial review unless the tax payer cannot practically invoke the relevant statutory procedure. Cases of that kind are likely to be extremely rare. [61]

The Court concluded that Mr Mawhinney's fourth cause of action does not by any measure qualify itself as being of the rare kind envisioned by the Supreme Court in *Tannadyce*, and thus should be struck out.

The Court further held that the fourth cause of action was prima facie vexatious because it concerns precisely those issues already subject to consideration in other pending litigation. The Court found the fourth cause of action was a duplication of process and an abuse of process, because Mr Mawhinney was attempting to relitigate a matter already determined, while duplicating the proceedings already underway pursuant to the disputes process.

Security for costs application

The Commissioner sought, as security for costs, $40,000 and for the proceeding to be stayed until the sum is paid or security given.

The Commissioner argued that the cost of defending the litigation is unjustified, particularly as it is overly complicated and unnecessarily protracted and the Trust will be unable to pay costs if unsuccessful.

It was not challenged that the Trust has inadequate resources to meet any costs. However, Mr Mawhinney opposed costs saying that he personally would be able to meet those costs, and furthermore, in his view, the claim has a very strong prospect of success.

The Court found there was no clear reason to believe costs could be paid if the claims are unsuccessful. It was not sufficient for Mr Mawhinney to claim he would meet costs.

While the Court did not attempt an overall assessment of the claims as to the merits, it noted that in a prior decision on Mr Mawhinney's summary judgment claim, Bell J found that the Commissioner had an arguable defence to the claims. The Court also noted that a number of Mr Mawhinney's pleaded causes of action face significant hurdles.

The Court reviewed the Commissioner's calculations of attendances in connection with the trial and came to the opinion that should the Commissioner succeed in due course, costs to be awarded would exceed the sum of $40,000 by a comfortable margin.

INCOME – ONUS ON DISPUTANT

Case	TRA 26/11 [2014] NZTRA 09
Decision date	14 July 2014
Act(s)	Tax Administration Act 1994
Keywords	Income, onus of proof

Summary

The disputant claimed that apart from wages and interest earned in 2000 and 2001, he had not earned any money since 1988. The disputant gave evidence of having received inheritances and money from friends and family so that he could spend his time on charitable work. He also gave evidence of having withdrawn money from his various banks accounts and deposited it in his Global Plus accounts.

The Taxation Review Authority ("TRA") found that the disputant had not discharged his onus of proof to satisfy the TRA that the deposits are not income. In addition the TRA found that the disputant knew that he could rely upon gifts to fund his living expenses and to be able to continue his charitable activities. He accepted these gifts and used the funds to live on. On this basis, the TRA considered the amounts were income.

Impact of decision

The decision confirms that where deposits are able to be linked to a particular source, the onus still remains on the disputant to prove that those deposits are not income. Further, where a disputant has come to rely upon monetary gifts to live on, those amounts are income.

Facts

The Commissioner of Inland Revenue's ("the Commissioner") investigation into the disputant's tax affairs identified multiple unexplained deposits in the disputant's bank accounts in the 2000–2006 tax years. The Commissioner issued income tax default assessments for the 2000 to 2006 income tax years and registered the disputant for goods and services tax ("GST") with effect from 1999.

The disputant maintained that he had not earned any income from any paid employment or business activity since 1988. He claimed that the multiple deposits were inheritances, savings, gifts, loans and loan repayments from friends. He claimed he was involved in charitable work and did not earn any income in the relevant tax years, apart from some wages and interest earned in 2000 and 2001.

In particular, the disputant also gave evidence that he created a charitable trust ("A Trust"). As part of A Trust's initiatives, he established a martial arts school and with his wife he established a modelling school. He explained that he spent much of his time working on the curriculum for his martial arts school and building websites so that the programmes were available on the internet. He also worked on a business development programme for young people.

The disputant also gave evidence that together with his colleagues he set up the E Group. It was set up to be the commercial division of the A Trust with the intention that income earned would be used to fund the charitable activities of A Trust.

In addition, the disputant gave evidence of particular deposits that he said accounted for the unexplained deposits identified by the Commissioner. In particular, the disputant and his wife gave evidence that it was their practice to withdraw money from their various accounts (CBA account, Paritate Bank and ASB) using ATMs and then deposit the cash into his Global Plus accounts.

Decision

Judge Sinclair considered the particular withdrawals and deposits that the disputant said accounted for the unexplained deposits identified by the Commissioner. In relation to the cash withdrawals from the CBA account, Judge Sinclair found as follows:

1. In the 2000 tax year, $6,880 could be matched to withdrawals.
2. In the 2001 tax year, on a generous approach, there was sufficient linkage between the date and amount of the withdrawal and deposit in the transactions in the period from 4 April 2001 to 3 May 2001 and the further withdrawal and deposit from 5 May 2001. These amounts totalled $12,140.
3. There was no such linkage for any of the other deposits.

However, Judge Sinclair accepted the Commissioner's submission that it is not a question of simply adding up all the deposits over the course of the income year and setting them off against withdrawals from the CBA account. Evidence is required linking the withdrawal to the deposit and the onus of proof is on the disputant to satisfy the TRA that those deposits are not income. Judge Sinclair

was not satisfied on the evidence that the deposits into the disputant's Global Plus account (identified as linked to withdrawals from the CBA account) were not income.

The disputant alleged that Mr LM, an associate, paid his rent and that these amounts were repayment of amounts he had loaned to Mr LM in the 1980s. Judge Sinclair did not consider that any of the unexplained deposits could be linked to any payment by Mr LM and in any event it was unclear whether they were loan repayments or gifts.

Judge Sinclair found that it was possible to identify approximately $13,000 only deposited into the disputant's bank account from withdrawals from the Paritate Bank. Even if it had been possible to identify other deposits as being from this source, Judge Sinclair was of the view that they would still be taxable as income.

The disputant gave evidence he received NZ$246,000 from a friend and he invested $220,000 of it in an offshore investment which failed. He was able to recover NZ$125,000. Judge Sinclair found that there was no evidence as to where the recovered funds were deposited nor in fact any evidence of the investment.

Judge Sinclair found that there was no deposit that matched the purported $5,000 that the disputant claimed had come from his family trust and been deposited into his ASB Moneymaker account.

The disputant gave evidence that he was given money by complete strangers who heard of his charitable work. In cross examination, he said the moneys given to him by friends and others were gifts with no obligation to repay and he told the TRA he had not paid back any of the money received by him over the years. He also told the TRA that some of the deposits were for the repayment of loans and that he neither documented the loans nor kept any repayment schedule. Judge Sinclair found that no loan repayments were specifically identified and linked to any deposit.

The disputant gave evidence of his "money pots" system where money was held in different pots depending upon its usage. Judge Sinclair found the disputant had no way of accounting for the funds he put into or took out of these pots, or how those funds were used.

Judge Sinclair found that some of the amounts assessed were gifts. However, the TRA considered that it was plain on the evidence that the disputant knew that he could rely upon that support to fund his living expenses and to be able to continue his charitable activities. Rather, he accepted these gifts and used the funds to live on. On this basis, Judge Sinclair considered the amounts were income. Judge Sinclair confirmed the Commissioner's assessments for income tax (subject to an adjustment on the incorrect inclusion of reimbursement costs and the reversal of the GST assessments).

Judge Sinclair found that E Group did not trade and she was satisfied on the evidence that in the income years in question, the disputant's activities were focused on his charitable work. Judge Sinclair was satisfied on the balance of probabilities that the only income included in the undisclosed deposits had been derived from charitable work. The disputant made supplies in the form of his charitable work. However, there was no consideration for those supplies and therefore no taxable activity. Accordingly, Judge Sinclair was satisfied that the disputant was not liable to account for GST and reversed the GST assessments.

Judge Sinclair confirmed the Commissioner's assessment for shortfall penalties under section 141C of the Tax Administration Act 1994. Judge Sinclair found that a reasonable person with the disputant's background and experience would have foreseen that his conduct would have resulted in a tax shortfall occurring. The disputant did not meet the standards of a reasonable man in his position in complying with his tax obligations.

NO INVOICE WHERE CONTRACT CONDITIONAL

Case	TRA 023/12 [2014] NZTRA 10
Decision date	24 July 2014
Act(s)	Goods and Services Tax Act 1985
Keywords	Invoice, time of supply

Summary

The vendors of subdivided lots ("the Trust") issued documents headed "GST Tax Invoice" before the agreements for sale and purchase of those lots became unconditional. The Taxation Review Authority ("TRA") held that an invoice required a debt due, which occurred only when the vendor had completed all steps necessary to demand payment.

Impact of decision

The decision confirms that an invoice is a document that informs an obligation to make present payment.

Facts

The Trust is in the business of land development and in 2010 entered into agreements for the sale and purchase of four lots of land before the subdivision of that land had been completed. Each agreement was conditional on the

issue of a certificate of title and on satisfying section 225 of the Resource Management Act 1991, which required survey plans to be deposited and approved. Additionally, the purchasers paid deposits, which were held on a stakeholder status until the agreements became unconditional.

Before the goods and services tax ("GST") rate increased to 15% on 1 October 2010, the Trust issued a document for each sale headed "GST Tax Invoice" with GST to be paid at 12.5%.

The Commissioner of Inland Revenue ("the Commissioner") held that the document did not constitute an invoice for GST purposes as there was no obligation to pay at the time the document was issued. The Commissioner held that the supply of the four lots was deemed to have taken place in the GST period ended 30 November 2010 when the titles were issued and the stakeholder status of the deposits ended.

The Trust challenged the Commissioner's reassessments on the basis the documents were invoices and accordingly supply took place on 29 September 2010.

Decision

Invoice

The issue as to whether the documents were invoices centred on whether there was an obligation to make payment at the time the documents were issued. The Trust argued that the obligation to make payment arose on the signing of each of the agreements for sale and purchase and payment of the deposits. The Commissioner argued there was no obligation until there was a debt due and that occurred only when the Trust had completed all steps required to demand payment under the terms of the contract. In this case, it required the deposit of the survey plans for three of the four lots and issue of title for all lots.

The TRA agreed with the Commissioner. The deposits were held by the Trust's lawyers as stakeholder until the vendor became entitled to them. The agreements themselves were subject to the deposit of the survey plans and issue of title, which did not occur until November 2010. Therefore, there was no present obligation to make payment at the time the documents were issued. Accordingly, the document headed "GST Tax Invoice" could not be an invoice for GST purposes.

Time of supply

As above, the TRA found the supply took place when payment was received by the supplier. Here, this was when the stakeholder status of the deposits ended and the Trust became entitled to them. Given the terms of the contract, this was when the agreements became unconditional, which was on 25 November 2010.

PRIVILEGE FOR IN-HOUSE LEGAL ADVICE NOT WAIVED

Case	Accountants First Limited v Commissioner of Inland Revenue [2014] NZHC 1723
Decision date	23 July 2014
Act(s)	Evidence Act 2006
Keywords	Legal professional privilege, waiver

Summary

The High Court dismissed the application. The Court found that advice provided to the Commissioner of Inland Revenue ("the Commissioner") by an in-house lawyer was privileged. Privilege in the legal advice had not been waived by the Commissioner.

Impact of decision

The advice of in-house lawyers attracts privilege in the normal way and will be upheld if they are not involved in the executive function. The court will be reluctant to go behind a lawyer who provides evidence that they were giving legal advice in the course of providing professional legal services.

Waiver in terms of section 65(3)(a) of the Evidence Act 2006 will only occur if the legal advice is put into issue in the proceeding. It is well established that this requires both asserting reliance on the advice, as well as injecting the substance of the advice into evidence. A bare reference to legal advice will be insufficient to amount to a waiver of privilege.

Facts

This decision relates to an interlocutory application brought by the applicant ("Accountants First Ltd") challenging the Commissioner's claim of legal professional privilege for advice provided by an in-house lawyer employed by the Commissioner.

The substantive matter is a judicial review. The applicant is a tax agent. Along with its principal, Mr Imran Kamal, the applicant was convicted of tax evasion under the Tax Administration Act 1994 ("TAA"). Consequently, a decision was made by the Commissioner under section 34B of the TAA to remove the applicant from the list of tax agents. The applicant is seeking judicial review of that decision.

Decision

The Court found that the lawyer's role in the process leading to the decision to cancel the applicant's standing as a tax agent did not compromise his status within the

process as an independent legal adviser. The legal advice in issue was given in direct response to a request for legal advice and the circumstances did not undermine the subsequent claim of privilege. There was no strength to the allegation of waiver.

Legal advice

In *Martinovich v Commissioner of Inland Revenue* [2014] NZHC 1357 at [29], Fogarty J asked whether the in-house provider of advice was:

> A lawyer on the Commissioner's staff who is a decision maker, exercising a delegated power to decide and thus performing an executive function, on the one hand, [or] a lawyer giving legal advice to a decision maker.

The applicant submitted the lawyer in question was so involved in the decision-making process that led to the removal of the applicant's tax agent status that his advice documents did not attract legal privilege.

Privilege was claimed over two documents. The first was advice given by email following a request on 8 August 2013 for legal advice in relation to the applicant's matter from the manager of the Community Compliance Unit of the Customer Services Group.

The second document was created eight days later. Another official involved in the process asked the lawyer for a copy of the legal advice and for further legal advice on the matter. This was provided by email.

The Court found that the circumstances supported the claim of privilege. The lawyer was employed to give internal legal advice. The lawyer described the request as being legal advice and the Court saw no reason to go behind that.

Further, the Court found the fact that the lawyer later authored a document within the process that did not attract privilege did not undermine the character of the advice given a month earlier.

The Court also noted that the lawyer was not in any sense the decision maker. His advice may be an important part in the process, but as noted in *Miller v CIR* (1997) 18 NZTC 13,001 at 13,020, that did not rob it of its privileged status.

Waiver

The Court found there was nothing in this argument. The decision maker prepared an affidavit for the purposes of the judicial review proceeding in which she identified the documents that she had, and which she considered in reaching her decision. That was the only reference to the legal advice. The decision maker did not claim to have specifically relied on the advice, to have found it influential, nor did she seek to write the contents of the advice into her affidavit.

The Court held that it was well established that mere reference to a document does not threaten privilege, and that was the case here. While the limits inherent in judicial review, for example no cross-examination, mean the obligation of candour is strong, it does not mean that privilege did not apply or that there was something wrong in claiming it.

APPLICATION BY TRINITY INVESTORS TO STRIKE OUT OR STAY COMMISSIONER'S LIQUIDATION PROCEEDINGS

Case(s)	The Commissioner of Inland Revenue v Ben Nevis Forestry Ventures Limited CIV 2014-404-4673; The Commissioner of Inland Revenue v Bristol Forestry Ventures Limited CIV 2013-404-4676 [2014] NZHC 1746
Decision date	25 July 2014
Act(s)	Tax Administration Act 1994, Companies Act 1993, Crown Law Proceedings Act 1950
Keywords	Liquidation, insolvency, Trinity, strike out, stay

Summary

Courtney J dismissed the defendants' application to strike out or stay the Commissioner of Inland Revenue's ("the Commissioner") liquidation proceedings. She found the Commissioner was a creditor for the purposes of recovering tax and further that the application to appoint liquidators was not premature on the part of the Commissioner.

Impact of decision

The decision clearly affirms the Commissioner's powers to pursue liquidation steps against litigious debtors. The judgment discusses the public interest in the Commissioner pursing liquidation to maintain the integrity of the tax system.

Facts

This judgment relates to an application made by the Commissioner to have liquidators appointed to the defendants.

The defendants were involved in the Trinity tax avoidance scheme and the debts relate to their 1997/1998 assessments, which were ultimately confirmed by the Supreme Court in *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289.

The defendants applied to strike out the Commissioner's application on the ground that she is not a creditor of the companies and therefore lacks standing to bring the proceedings. In the alternative, they sought a stay of the proceedings.

In addition to the above, the defendants also say the liquidation would be premature because there are decisions pending on various appeals and separate proceedings afoot, which, if successful, may result in the tax claimed being extinguished.

Decision

The strike out

Are the liquidation proceedings a suit?

First, Courtney J considered whether liquidation proceedings are a suit for the purposes of section 156 of the Tax Administration Act 1994 ("TAA").

She considered the Commissioner's power to recover unpaid taxes under sections 6A(2) and 6A(3) of the TAA, plus the power and method conferred on the Commissioner under section 156, which provides:

> All unpaid tax shall be recoverable by the Commissioner on behalf of the Crown by suit in the Commissioner's official name.

She also noted the effect of the Crown Proceedings Act 1950, which is specifically preserved under section 164 of the TAA.

Are the liquidation proceedings a suit for the recovery of tax?

Satisfied the liquidation proceedings are a suit for the purposes of section 156 of the TAA, Courtney J went on to look at whether a liquidation proceeding was a suit for the recovery of unpaid tax as contemplated by section 156 of the TAA.

She found the liquidation proceedings are a form of debt recovery and therefore the Commissioner's application for an order that a liquidator be appointed was a suit for the recovery of unpaid tax.

Her Honour relied on the Privy Council decision *Cambridge Gas Transport Corp v Unsecured Creditors of Navigator Holdings PLC* [2006] UKPC 26, [2007] 1 AC 508 at [14]–[15] where Lord Hoffman said:

> The purpose of bankruptcy proceedings ... is not to determine or establish the existence of rights, but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established. That mechanism may vary in its details ... The important point is that bankruptcy, whether personal or corporate, is a collective proceeding to enforce rights and not to establish them.

Is the Commissioner a creditor for the purposes of the liquidation proceedings?

Her Honour then considered whether the Commissioner is a creditor under section 241(2)(c) of the Companies Act 1993 ("Companies Act"). The defendants argued the Commissioner is not a creditor because tax is public money and a property of the Crown. They argued this makes the Crown the creditor and the Commissioner an agent charged with the collection of a debt.

Courtney J found the Commissioner is a creditor for the purposes of section 241(2)(c)(iv). She found the opening words of section 240(1) "unless the context otherwise requires" meant the definition of creditor under section 241(2)(c) is not exhaustive and the context may require it to be interpreted more widely than is set out. She considered that the context in this case did require a wider interpretation basing this on both the purpose of the Companies Act and other provisions relating to creditors.

Courtney J therefore dismissed both the defendant's strike-out application arguments.

The stay application

Application for stay principles

To begin, Courtney J set out the principles relating to an application for stay in winding up proceedings. Summarised by Wallace J in *Nemisis Holdings Ltd v North Harbour Industrial Holdings Ltd* (1989) 1 PRNZ 379, citing *Exchange Finance Co Ltd v Lemington Holdings Ltd* [1984] 2 NZLR 242 (CA); *Anglian Sales Ltd v South Pacific Manufacturing Co Ltd* [1984] 2 NZLR 249 (CA); *Fletcher Development & Construction Ltd v New Plymouth Hotels Holdings Ltd* [1986] as:

> 1.1. The Court has an inherent jurisdiction to stay winding up proceedings where the debt is the subject of a genuine dispute;
>
> 1.2. The jurisdiction is an inherent one to prevent the abuse of process. There is no inflexible rule;
>
> 1.3. The governing consideration is whether the proceedings suggest unfairness or undue pressure;
>
> 1.4. It is a serious matter to stay winding up proceedings and a decision to do so is not to be made lightly. The onus is on the applicant and it is normally necessary to demonstrate "something more" than the balance of convenience considerations usually considered on an application for an interim injunction.

The outstanding appeals and proceedings

Courtney J rejected the defendants' submission that the strike-out application raised complex issues of law, stating: "the issue raised in this appeal cannot truly be described as complex nor is it novel; it has been raised and rejected in other proceedings".

She went on to say for the many pending appeal decisions at [40] (CIV-2013-404-004673; CIV-2013-204-004676 [2014] NZHC 1746):

> I do not accept that these circumstances justify staying the Commissioner's proceedings. This is not an application for a stay sought for a short time pending the determination of a genuinely new point where the decision would assuredly spell the end of the litigation. There is no reason to think that if the outcome of the appeals or the proceeding against the Attorney-General in this Court is adverse to the defendants, it will be accepted as determinative of the defendants' position. The history of this matter shows only that the defendants will continue to litigate, notwithstanding their insolvent state, until they get the answer they want.
>
> Further, there is no prejudice to the defendants in the appointment of a liquidator, since they are not trading and have no assets. It was not suggested that, even if the appeals were successful, this position would change …

Her Honour concluded at [43]:

> I am mindful of the Court of Appeal's caution in Anglian Sales against too readily precluding the exercise of the Commissioner's statutory rights. Although it seems very unlikely that the tax will be paid, that fact should not be determinative. There is a significant public interest in maintaining the integrity of the taxation system through the resolution of unpaid tax debt. It ought not to be the case that apparently insolvent companies owing large amounts of tax can simply not pay while at the same time continuing to engage the Commissioner in costly and time-consuming litigation. That is a spectacle that surely undermines the taxation system and risks bringing it into disrepute in the eyes of other taxpayers.

Consequently Her Honour also rejected the defendants' stay application.

CLAIMS STRUCK OUT FOR BEING FILED OUT OF TIME

Case(s)	TRA 006/14 [2014] NZTRA 11; TRA 007/14 [2014] NZTRA 12
Decision date	25 July 2014
Act(s)	Tax Administration Act 1994
Keywords	Response period

Summary

The disputants' claims in relation to income tax assessments are struck out for being filed out of time. The disputants have 14 days to decide whether to pursue claims in respect of shortfall penalties.

Impact of decision

The Commissioner of Inland Revenue ("the Commissioner") has no authority to waive the timing requirements for a challenge being filed.

Facts

The disputants are partners in a farming partnership. The disputants claim to have made an election in the 2009 year to cease valuing their herd using the herd scheme valuation method. However, the Commissioner has no record of an election being made in that year.

The Commissioner has assessed the disputants for additional income tax arising from the different valuation method used. The disputants challenged the Commissioner's assessments. This preliminary matter is about whether the disputants' Notices of Claim were filed in time.

On 21 March 2013, the Commissioner assessed the disputants for income tax for the year ended 31 March 2009 ("the income tax assessments").

On 23 March 2013, the Commissioner assessed the disputants for an unacceptable tax position shortfall penalty for the tax shortfall arising from the income tax assessments ("the shortfall penalty assessments").

On 23 May 2014, the disputants each filed a Notice of Claim in the Taxation Review Authority ("the TRA"). The Notices of Claim refer to disputable decisions made by the Commissioner on 23 March 2014, but appear to challenge only the income tax assessments made on 21 March 2014.

No application to commence a challenge out of time (under section 138D of the Tax Administration Act 1994) was made.

The Commissioner decided to bring the issue of timing to the TRA's attention on the basis that the Commissioner did not have the power to waive the statutory requirements in relation to when a challenge could be filed (see *Reckitt and Colman (New Zealand) Ltd v Taxation Board of Review* [1966] NZLR 696 (SC); [1966] NZLR 1032 (CA)).

Decision

The TRA held that although the income tax and shortfall penalty assessments arose from the same factual context, and the quantum of the shortfall penalty assessment related to the tax shortfall arising from the income tax assessment, the assessments were separate disputable decisions. Time limits applied from the date of issue of each Notice of Assessment (ie, 21 March 2014 for the income tax assessments and 23 March 2014 for the shortfall penalty assessments).

The TRA was satisfied that the challenges to the income tax assessments were filed out of time. In the absence of any applications to extend the time for filing a challenge, the challenges to the income tax assessments were struck out.

Although no particular mention was made of shortfall penalties in the Notices of Claim, there was sufficient mention of matters relating to the shortfall penalty assessments (ie, the 23 March 2014 date and letters dated 18 March 2014 that mention the shortfall penalties) for the Notices of Claim to apply to the shortfall penalty assessments. A challenge in respect of the shortfall penalty assessments was made in time.

The disputants have 14 days to advise the TRA whether they wish to proceed with the challenge to the shortfall penalty assessments only.

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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.

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