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TAX INFORMATION
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CONTENTS

Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

IN SUMMARY

Binding rulings

New legislation

Legislation and determinations

Legislation and determinations (continued)

Special Determination S31: Application of financial arrangements rules to Investors in the Lifetime Income Fund 32

The Arrangement is the Lifetime Income Fund (the Fund), which is a retirement product in which members of the general public can invest their retirement savings. The Fund will manage the investment in a similar manner to a KiwiSaver scheme through the Balanced Portfolio which will invest in low cost share and fixed interest index funds. The Fund will also manage distributions to provide income for the Investor over their retirement lifetime (from age 65 onwards). The Determination sets out that the Arrangement is a financial arrangement under s EW 3. The units in the Fund are excepted financial arrangements under s EW 5(13) and the annuity provided is an excepted financial arrangement under s EW 5(2).

Questions we've been asked

QB 14/13: GST – Lotteries, raffles, sweepstakes and prize competitions 34

This QWBA explains the GST rules for conducting a raffle, lottery, sweepstake or prize competition. This may be of interest to non-profit groups who run these events as part of their fundraising activities. Essentially, where a registered person is running one of these events, GST needs to be accounted for on any ticket sales less any cash prizes paid or payable. The QWBA covers similar content to BR Pub 07/11 "GST – Lottery operators and promoters", which expired on 21 December 2012. It does not represent a change in view by the Commissioner and the item does not apply to racing or sports betting.

QB 14/14: GST – Late return charges (including library fines and parking overstay charges) 40

This item updates and replaces the part of *Public Information Bulletin*, No 148 (May 1986): 3 that relates to the GST treatment of library fines and vehicle parking fines. However, the analysis in the item extends to all charges imposed for the late return of a borrowed item.

In most cases a late return charge will be subject to GST because the legal arrangements entered into between the parties will characterise the charge as additional consideration for the supply of a borrowed item.

However, in some cases the legal arrangements between the parties may characterise the late return charge as a payment of damages or a penalty for a breach of the legal arrangements. In these cases the charge will not be subject to GST because it will not be consideration for a taxable supply.

Items of interest

Relationship property agreements – GST implications 43

The Commissioner does not intend to issue a public statement on this matter because the situations involving relationship property agreements originally identified as giving rise to GST issues infrequently arise in practice now. Ordinary GST provisions and principles continue to apply.

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**

PUBLIC RULING BR PUB 14/09: INCOME TAX – MEANING OF "ANYTHING OCCURRING ON LIQUIDATION" WHEN A COMPANY REQUESTS REMOVAL FROM THE REGISTER OF COMPANIES

This is a reissue of BR Pub 10/06. For more information about the history of this Public Ruling see the Commentary to this Ruling.

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

Taxation Laws

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

This Ruling applies in respect of para (b)(i) of the definition of "liquidation" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the liquidation of a company when a request is made under s 318(1)(d) of the Companies Act 1993 that the company be removed from the New Zealand register of companies.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- When a request is made to the Registrar of Companies to remove a company from the New Zealand register of companies under s 318(1)(d) of the Companies Act 1993, the first step legally necessary to achieve liquidation is a resolution by the shareholders or board of directors or, where applicable, another overt decision-making act provided for in a company's constitution to adopt a course of action that will end in removal from the register.
- That first step starts the period specified in para (b)(i) of the definition of "liquidation" in s YA 1. Anything done after that first step to enable liquidation occurs "on liquidation" for the purposes of the Income Tax Act 2007.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 January 2015.

This Ruling is signed by me on 20 November 2014.

Grant Haley
Manager, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 14/09

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 14/09 (the Ruling).

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

Summary

1. The purpose of this Ruling is to clarify the first step legally necessary to achieve liquidation when a request is made to the Registrar of Companies to remove a company with surplus assets from the New Zealand register of companies under s 318(1)(d) of the Companies Act 1993.
2. In the Commissioner's view, liquidation of a company is a process. Therefore, the phrase "anything occurring on liquidation", in particular the words "on liquidation", refer to a period. That period starts with the occurrence of the first step legally necessary to achieve liquidation. The Commissioner considers that, when a removal request is made under s 318(1)(d) of the Companies Act 1993, the first step legally necessary to achieve liquidation will ordinarily be the passing of the resolution to cease business, pay all creditors, distribute surplus assets and to then request removal from the register. Alternatively, the first step legally necessary may be another overt decision-making act that is provided for in a company's constitution to adopt a course of action that will end in the removal of the company from the register.
3. That step starts the period specified in para (b)(i) of the definition of "liquidation" in s YA 1. Anything done after that step to enable liquidation occurs "on liquidation" for the purposes of the Income Tax Act 2007.

4. Therefore, on a short-form liquidation, any capital distributions a company makes after the passing of a resolution to enable liquidation will be made "on the liquidation of the company" and may be excluded from being dividends under s CD 26.

Background

5. BR Pub 14/09 is a reissue of BR Pub 10/06, which expired on 31 December 2014. This Ruling is essentially the same as BR Pub 10/06.

6. The Ruling concerns the meaning of the phrase "anything occurring on liquidation" in para (b) of the definition of "liquidation" in s YA 1 when a request for removal from the register of companies is made under s 318(1)(d) of the Companies Act 1993.

7. Paragraph (a) of the definition of "liquidation" includes the removal of a company from the register of companies. The removal of a liquidated company from the register occurs under the Companies Act 1993 in a number of circumstances, including after the full liquidation process or after the shorter, alternative process provided by s 318(1)(d) of the Companies Act 1993. The alternative process under s 318(1)(d) is sometimes referred to as a "short-form liquidation".

8. A short-form liquidation is cheaper and simpler than a full liquidation. A short-form liquidation involves a request for the company's removal from the register by:
   - an authorised shareholder; or
   - the board of directors; or
   - any other person required or permitted to do so by the constitution of the company.

9. Relevant to this Ruling, such a request can be made to the Registrar of Companies only after the company has ceased to carry on business, paid its debts and distributed its surplus assets to its members: s 318(2)(a) of the Companies Act 1993.

10. Paragraph (b) of the definition of "liquidation" in s YA 1 prescribes the period during which an action or event will be considered to be occurring "on liquidation". This definition is important because specific tax consequences flow from acts that occur "on liquidation". Paragraph (b) of the definition of "liquidation" provides that the period known as "on liquidation" starts with "a step that is legally necessary to achieve liquidation".

11. Paragraph (b)(i) includes two examples of steps that are legally necessary to achieve liquidation:
   - the appointment of a liquidator; or
   - a request for removal under s 318(1)(d) of the Companies Act 1993.

12. The second example has given rise to uncertainty, which is why the Commissioner has issued this Ruling.

13. The issue is whether a request for removal under s 318(1)(d) of the Companies Act 1993 is the first step legally necessary to achieve liquidation. If so, on a short-form liquidation the period known as "on liquidation" will not begin until the request for removal from the register has been made under s 318(1)(d). Under the Companies Act 1993, that request cannot be made until any surplus assets have been distributed.

14. Such an interpretation would mean that companies that follow the short-form liquidation process may be unable to make tax-free distributions "on liquidation" under s CD 26(2). If a request for removal is the start of the "on liquidation" period, then all surplus assets must have been distributed before the request is made. Therefore, the purpose of this Ruling is to determine the correct interpretation of the phrase "anything occurring on liquidation" in the context of a short-form liquidation. In particular, the Ruling considers the meaning of the words "on liquidation".

Application of the Legislation

15. A request to remove a company from the register of companies under s 318(1)(d) of the Companies Act 1993 can be made by:
   - a shareholder authorised by shareholders' special resolution; or
   - the board of directors; or
   - any other person required or permitted by the constitution to do so.

16. It is clear from s 318(2) of the Companies Act 1993 that at the time a request for removal is made any surplus assets must have already been distributed.

17. The function of para (b) of the definition of "liquidation" is to set out the period when anything may occur on liquidation. Paragraph (b)(i) defines the period. The beginning of the period is most important and para (b)(i) provides that it starts with "a step that is legally necessary to achieve liquidation". This puts the focus on the first steps. Paragraph (b)(ii) limits "anything occurring on liquidation" to things occurring within that period that are "for the purpose of enabling liquidation". Things that occur for another purpose will not occur "on liquidation".

18. The importance of determining the first step legally necessary to achieve liquidation is highlighted when determining the tax treatment of capital distributions made on a short-form liquidation. Capital distributions may not be dividends for tax purposes

when they are made "on the liquidation" of a company under s CD 26.

19. Under s CD 3, the term "dividends" includes a wide variety of payments, distributions and transactions that essentially transfer value to shareholders. Sections CD 26(1) and (2) exclude from being a dividend any amounts distributed to shareholders that are essentially subscribed capital ("available subscribed capital per share") and capital gains ("available capital distribution amount") where the amounts are distributed "on the liquidation of the company".

What is meant by "a step that is legally necessary to achieve liquidation"?

20. The phrase "a step that is legally necessary to achieve liquidation" distinguishes between:
    - steps that are legally necessary and any other steps; and
    - steps that are to achieve liquidation and steps that are taken for another purpose.
21. The ordinary meaning of the word "step" implies an "action". Therefore, the focus is on overt acts rather than, for example, the existence of circumstances or beliefs.
22. Some steps necessary to achieve liquidation in practice may not be legally necessary. For example, a step that is necessary in practice for a liquidation by special resolution of shareholders is to decide who the liquidator will be. That decision is not a legally required step even though it must have occurred. The closest legally necessary step would be appointing the liquidator or obtaining the liquidator's written consent to appointment.
23. The words "to achieve liquidation" further narrow the range of steps that can start the period. Some steps legally necessary to achieve liquidation may be taken for a purpose other than to achieve liquidation. For example, paying all creditors is necessary before making a request under s 318(1)(d) of the Companies Act 1993. However, those payments may be made in the ordinary course of business rather than for the purpose of enabling liquidation.
24. Other steps undertaken may not reach the required threshold "to achieve liquidation". For each liquidation procedure, the series of steps involved will largely be settled by the governing legislation, usually the Companies Act 1993. However, for each procedure, some preliminary steps will usually occur before any decision to liquidate is made, with the final preliminary step being the making of the decision to liquidate. The decision to liquidate is then followed by a further series of steps that achieve the liquidation and removal of the company from the register of companies.
25. The word "achieve" requires an end or goal to have been established and committed to. In para (b) of the definition of "liquidation", the words "to achieve liquidation" mean the steps must be taken with liquidation as the established end. Therefore, the Commissioner's view is that steps cannot be said to have been taken "to achieve liquidation" until the decision to liquidate is established and committed to.
26. This emphasis on the established goal of liquidation means some steps that are preparatory to the removal of the company from the register (for example, the exercise by the liquidator of his or her functions) are capable of being the first step to achieve liquidation. However, a decision to liquidate must have been made.
27. While a decision to liquidate has to be made in practice, the step required by law in relation to a company's decision is usually the passing of a resolution. The silent making of a decision is not an overt act, so it is not a "step" as required by para (b)(i) of the definition of "liquidation". The Commissioner's view is that the passing of a resolution is an overt act—a "step"—and will, in most cases, be the first step legally necessary to achieve liquidation. The passing of such a resolution will also satisfy para (b)(ii) as being for the purpose of enabling liquidation.

What is the first step legally necessary to achieve liquidation on a short-form liquidation?

28. One of the two grounds in s 318(2) of the Companies Act 1993 must be satisfied before a request for removal from the register of companies under s 318(1)(d) can be made. However, only the first ground applies where the company has surplus assets to distribute. Therefore, the first ground is the only ground considered in this Ruling. The first ground requires the company to have ceased business, paid its creditors and distributed its surplus assets in accordance with its constitution and the Companies Act 1993.
29. Therefore, it follows that in those circumstances the first step that is legally necessary when a request is made to remove the company from the register should relate to ceasing business, paying all creditors and distributing surplus assets. Section 318(2)(a) of the Companies Act 1993 does not specify the order in which these events must occur.
30. Accordingly, the Commissioner accepts that the first step legally necessary to achieve liquidation, when a request is made to remove a company from the register of companies under s 318(1)(d) of the

Companies Act 1993, is a resolution to:

- cease business,
- pay all creditors,
- distribute surplus assets, and
- then request removal from the register of companies.

31. Other steps may be taken that could also be the first step that is legally necessary to achieve liquidation. For example, a company may act less formally than by passing a resolution to carry out the requirements in s 318(2) of the Companies Act 1993. If the step is overt and carried out with the aim of achieving removal from the register, it may still be the first step that is legally necessary to achieve liquidation. However, a company taking a less formal course of action may be required to produce evidence establishing that the taking of the step was carried out with the aim of achieving liquidation.

What is the significance of the examples in para (b)(i) of the definition of "liquidation" in s YA 1?

32. After the phrase "a step that is legally necessary to achieve liquidation", para (b)(i) of the definition of "liquidation" in s YA 1 sets out two examples: "including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993".

33. The examples can be read as being the first steps of the relevant processes, which Parliament put in the section as specific illustrations of first steps that start the period. However, in the Commissioner' view, the wording of para (b)(i) is ambiguous. The steps could be examples of:

- a step that is legally necessary to achieve liquidation; or
- the first step that is legally necessary to achieve liquidation.

34. Possibly, the more obvious meaning is that the examples are of first steps—suggested by the immediate context and the emphasis in the section. The focus of para (b)(i) is on determining "the period" and its commencement, which suggests the examples are of first steps rather than any steps of the processes to which they are relevant. However, this is not conclusive. Whether the examples should be taken to be the first steps or just any steps in the processes they are relevant to becomes clearer when the examples are examined.

35. The first example refers to the appointment of a liquidator. In the processes of liquidation, the appointment of a liquidator is not the first step legally necessary to achieve liquidation. For example, where the shareholders of a company resolve to appoint a liquidator, obviously the resolution is a legally necessary step that precedes the appointment.

36. Regarding the second example, when removal from the register is requested under s 318(1)(d) of the Companies Act 1993, the request is also not the first step legally necessary to achieve liquidation. As noted above, before removal from the register can be requested, the company must have ceased business, paid its creditors and distributed its surplus assets. These steps must all have occurred before requesting removal from the register. The Commissioner's view, therefore, is that passing a resolution to cease business, pay all creditors, distribute surplus assets and to then request removal will usually be the first step that is legally necessary to achieve liquidation. The Commissioner considers that any other interpretation would leave s CD 26(2) ineffective, which would not have been the intention of Parliament.

37. Therefore, the Commissioner's view is that the better interpretation of para (b)(i) is that the steps given as examples are not the first steps legally necessary to achieve liquidation in the liquidation processes they relate to. Instead, they are examples of steps (in fact, fundamental steps) in those processes. The Commissioner considers that a step other than one of the two examples included in para (b)(i) could be the first step that is legally necessary to achieve liquidation. And, as noted above, the Commissioner considers that step will usually be the passing of a resolution to cease business, pay all creditors, distribute surplus assets and then request removal.

What is the tax treatment of capital distributions made on a short-form liquidation?

38. Capital distributions may not be dividends for tax purposes when they are made "on the liquidation" of a company under s CD 26.

39. Paragraph (b) of the definition of "liquidation" in s YA 1 provides that the period known as "on liquidation" starts with the first step that is legally necessary to achieve liquidation. As discussed above, the Commissioner's view is that the first step is not the making of the request to remove the company from the register. The first step will ordinarily be the passing of the resolution to cease business, pay all creditors, distribute surplus assets and then request removal.

40. Therefore, any capital distributions made after the passing of such a resolution will be made "on the liquidation of the company" and may be excluded from being dividends under s CD 26.

41. In some cases, there may be an extended period between the first step legally necessary to achieve liquidation and the removal of the company from the register. The period may even span different tax years, so that a distribution is made in a period preceding the removal of the company from the register. The Commissioner will assume that such distributions are made pursuant to a genuine intention to liquidate. However, if the liquidation is not completed, then such a distribution will not have occurred "on liquidation" and the exclusion under s CD 26 (and this Ruling) will not apply.

42. Taxpayers making distributions should ensure they keep adequate records of relevant resolutions or other decision-making acts. This is so they can demonstrate that the resolution or other act was genuine, that the resolution or act preceded the distribution of the company's assets, and that the distributions were for the purpose of enabling liquidation.

References

Expired Rulings
BR Pub 05/14 "'Anything occurring on liquidation' when a company requests removal from the register of companies" *Tax Information Bulletin* Vol 17, No 10 (December 2005): 5
BR Pub 10/06 "Meaning of 'anything occurring on liquidation' when a company requests removal from the register of companies" *Tax Information Bulletin* Vol 22, No 5 (June 2010): 3
Subject references
Capital distributions; Liquidation; Short-form liquidation
Legislative references
Income Tax Act 2007 – s CD 26, and the definition of "liquidation" in s YA 1
Companies Act 1993 – s 318

APPENDIX – LEGISLATION

1. Section CD 26 relevantly provides:

> **CD 26 Capital distributions on liquidation or emigration**
>
> *When this section applies*
>
> (1) This section applies when a shareholder—
>
> (a) is paid an amount in relation to a share on the liquidation of the company:
>
> (b) is treated under section FL 2 (Treatment of emigrating companies and their shareholders) as being paid an amount in relation to a share in the company.
>
> *Return of subscribed capital or capital gains*
>
> (2) The amount paid is a dividend only to the extent to which it is more than—
>
> (a) the available subscribed capital per share calculated under the ordering rule; and
>
> (b) the available capital distribution amount calculated under section CD 44.
>
> ...

2. The definition of "liquidation" in s YA 1 reads:

> **liquidation**, for a company,—
>
> (a) includes—
>
> (i) removal of the company from the register of companies under the Companies Act 1993; and
>
> (ii) termination of the company's existence under any other procedure of New Zealand or foreign law; and
>
> (b) includes, in references in this Act to anything occurring on liquidation, anything occurring—
>
> (i) during the period that starts with a step that is legally necessary to achieve liquidation, including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993; and
>
> (ii) for the purpose of enabling liquidation

3. Section 318 of the Companies Act 1993 relevantly provides:

> **318 Grounds for removal from register**
>
> (1) Subject to this section, the Registrar must remove a company from the New Zealand register if—
>
> ...
>
> (d) there is sent or delivered to the Registrar a request in the prescribed form made by—
>
> (i) a shareholder authorised to make the request by a special resolution of shareholders entitled to vote and voting on the question; or
>
> (ii) the board of directors or any other person, if the constitution of the company so requires or permits—

that the company be removed from the New Zealand register on either of the grounds specified in subsection (2); or

...

(2) A request that a company be removed from the New Zealand register under subsection (1)(d) may be made on the grounds—

(a) that the company has ceased to carry on business, has discharged in full its liabilities to all its known creditors, and has distributed its surplus assets in accordance with its constitution and this Act; or

(b) that the company has no surplus assets after paying its debts in full or in part, and no creditor has applied to the court under section 241 for an order putting the company into liquidation.

(3) A request that a company be removed from the New Zealand register under subsection (1)(d) must be accompanied by a written notice from the Commissioner of Inland Revenue stating that the Commissioner has no objection to the company being removed from the New Zealand register.

...

PUBLIC RULING BR PUB 14/10: FBT – PROVISION OF BENEFITS BY THIRD PARTIES – SECTION CX 2(2)

This is a reissue of BR Pub 09/07. For more information about the history of this Public Ruling see the Commentary to this Ruling.

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

Taxation Laws

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

This Ruling applies in respect of s CX 2(2) and the definition of "arrangement" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a benefit by an employee from a third party where there is an arrangement between the employer and the third party and where the benefit would amount to a "fringe benefit" if it had been provided by the employer.

The Arrangement does not include situations where the remuneration given by an employer to an employee is reduced because a benefit has been received from the third party, or otherwise takes the receipt of a benefit provided by a third party into account (including salary sacrifice situations). There cannot be any trade-off between the benefits provided and the remuneration that would otherwise have been received by the employee, or any difference between the remuneration levels of employees who receive benefits and those who do not.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) For the purposes of s CX 2(2), there will be an arrangement for the provision of a benefit to an employee where:

   i) consideration passes from the employer to the third party for the benefit being provided; or

   ii) the employer requests (other than merely initiating contact), instructs or directs the third party to provide the benefit; or

   iii) there is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employee; or

   iv) the third party and the employer are associated parties and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.

b) Where the benefit has not been provided in circumstances within any of the categories identified above, s CX 2(2) will not apply where the benefit is provided in any of the following circumstances:

   i) there is negotiation or discussion between the employer and the third party that results in no more than:

      A) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or

      B) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or

      C) the employer agreeing to advertise or make known the availability of the benefit; or

   ii) the employer has done no more than initiate contact or discussions with the third party; or

   iii) there is no significant contact between the employer and the third party.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2014/2015 income year.

This Ruling is signed by me on 28 November 2014.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 14/10

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 14/10 (the Ruling).

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

Summary

1. A benefit will be treated as having been provided to an employee under s CX 2(2) where an "arrangement" is made between their employer and another person "for" the "benefit" to be "provided".
2. "Arrangement" is defined in s YA 1 and encompasses various degrees of formality and enforceability. An "arrangement" may be a legally enforceable contract, a less formal agreement or plan, or an informal, unenforceable understanding. An "arrangement" may exist even if no consideration is given by the employer to the third party so as to create a legally binding contract.
3. Section CX 2(2) provides that the arrangement made between the employer and another party must be "for the benefit to be provided". These words mean that the arrangement must be made "for the purpose" or "with the object" of providing a benefit to an employee. This requires consideration of the purpose or object of the employer and third party in making the arrangement.
4. Where the employer and the third party have a different purpose or object in making the arrangement, s CX 2(2) will apply only if the employer's purpose or object in making the arrangement was to provide a benefit to an employee.
5. In determining the employer's purpose or object, the relevant consideration is the subjective purpose or object of the employer in making the "arrangement". For s CX 2(2) to apply, the employer must have, at least, a more than incidental purpose or object of providing a benefit to an employee in making the arrangement.
6. An employee–third party arrangement for a benefit to be provided does not prevent the same benefit being considered as having been provided through an employer–third party arrangement to which s CX 2(2) applies.
7. A "benefit" for s CX 2(2) purposes is an advantage that is sufficiently clear and definite that it can reasonably, practically and sensibly be understood as a tangible benefit.
8. For s CX 2(2) to apply, the benefit must have been "provided" to an employee by a third party. The word "provided" requires that the benefit must have been supplied, furnished or made available to the employee.
9. The Commissioner considers that these requirements will be met and s CX 2(2) will apply where:
   - consideration passes from the employer to the third party for the benefit being provided;
   - the employer requests (other than merely initiating contact), instructs or directs the third party to provide a benefit;
   - there is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employee; or
   - the third party and the employer are associated parties and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that an employee of the group will be entitled to receive benefits from the other companies in the group.
10. Where the benefit has not been provided in circumstances within any of the categories identified above, s CX 2(2) will not apply where the benefit is provided in any of the following circumstances:
    - there is negotiation or discussion between the employer and the third party that results in no more than:
      - the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
      - agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
      - the employer agreeing to advertise or make known the availability of the benefit; or
    - the employer has done no more than initiate contact or discussions with the third party; or
    - there is no significant contact or arrangement between the employer and the third party.
11. A benefit may be provided in circumstances that fall within both of the above categories. In such cases, the Commissioner considers the requirements of s CX 2(2) have been satisfied. For example, if a benefit is provided in circumstances that come within the "requests …, instructs or directs" category in [9] above, s CX 2(2) applies even if it can be argued that those circumstances also come within the "agreement

... as to the level of benefit that is to be offered" subcategory in [10].

12. A consequence of this Ruling may be that the employer is required to put into place systems to enable them to obtain the relevant information required to fulfil their fringe benefit tax (FBT) obligations. In the Commissioner's opinion, where the employer is involved in the types of arrangements contemplated in [9] above, the employer will generally have a sufficient relationship with the third party to obtain the information they require to fulfil their obligations. The onus is on employers who are involved in arrangements for the provision of benefits in any of these ways to ensure that they can comply with their obligations (for example, by requiring record keeping by the third party).

13. This Ruling does not consider or rule on the taxation implications of salary sacrifice situations. Different considerations may apply to determine the tax treatment. For example, the benefit may have been provided by the employer in such a situation, or there may be other relevant aspects of the arrangement. These considerations may affect whether or not s CX 2(2) will have any application.

Background

14. BR Pub 14/10 is a reissue of BR Pub 09/07, which expired on the last day of the 2013/2014 income year. This Ruling is essentially the same as BR Pub 09/07. However, the analysis under the heading "What is the meaning of "benefit"?" has been amended to ensure consistency with other statements made by the Commissioner. The Commissioner considers that these changes do not affect the outcome of this Ruling.

15. This Ruling considers the scope of s CX 2(2) and what will be an "arrangement" that falls within the scope of that provision.

Application of the Legislation

Introduction

16. Under the Act, an employer may be liable to pay FBT on fringe benefits that it provides to an employee. "Fringe benefit" is defined in s CX 2(1) as follows:

> *Meaning*
>
> (1) A **fringe benefit** is a benefit that—
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
>
> (ii) is an unclassified benefit; and
>
> (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

17. This definition is broad and intended to include all non-cash payments made by an employer to an employee in connection with their employment.

18. As a rule, an employer will not be liable to pay FBT on a benefit provided to an employee by a third party. However, under s CX 2(2) an employer may be liable to pay FBT on a benefit provided to an employee by a third party if that benefit is provided through an "arrangement" made between the employer and the third party.

19. Section CX 2(2) provides:

> *Arrangement to provide benefit*
>
> (2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

20. Section CX 2(2) is an anti-avoidance provision. Its purpose is to prevent an employer avoiding a liability for FBT by arranging for a third party to provide a benefit to an employee in circumstances where FBT would have been payable had that benefit been provided by the employer directly. If s CX 2(2) applies, the benefit provided by the third party is treated as if it were provided by the employer to the employee directly. This enables the other provisions of subpart CX to be applied to determine whether FBT is payable on the benefit.

21. This Ruling considers only what will be an "arrangement" that comes within the scope of s CX 2(2). It does not consider whether FBT will be payable on a benefit that is provided through an arrangement to which s CX 2(2) applies. An arrangement may satisfy the requirements of s CX 2(2), but no FBT will be payable because of the other provisions of subpart CX or the operation of the valuation rules in subpart RD.

Issue

22. A benefit will be treated as having been provided by an employer to an employee under s CX 2(2) where an "arrangement" is made between the employer and another person "for" the "benefit" to be "provided".

23. The wording of s CX 2(2) is broad and would apply where any form of consideration passes from an employer to a third party to compensate for the third party providing a benefit to an employee. However, where there is no direct or indirect consideration (in any form) provided by the employer to the third party,

the issue is in what circumstances the provision will apply.

24. In considering this issue, the analysis below will consider:
    - What is meant by "arrangement"?
    - What is the meaning of "for"?
      - Is it the purpose of the arrangement or purpose of the parties?
      - Which party's purpose is relevant?
      - Is it an objective or subjective test?
      - Which purpose test should be applied?
      - Can s CX 2(2) apply where there is an employee–third party arrangement?
    - What is the meaning of "benefit"?
    - What is the meaning of "provided"?

What is meant by "arrangement"?

25. "Arrangement" is defined in s YA 1 as follows:

> **arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

26. This definition makes it clear that "arrangement" is very wide in its application, and that it encompasses not only legally binding contracts, but also unenforceable understandings. It is clear that what is required for an arrangement to exist is less than that required for a binding contract.

27. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines the individual words contained in the s YA 1 definition as follows:
    - "Agreement" – a negotiated and typically legally binding arrangement.
    - "Contract" – a written or spoken agreement intended to be enforceable by law.
    - "Plan" – a detailed proposal for doing or achieving something.
    - "Understanding" – an informal or unspoken agreement or arrangement.

28. The above definitions show that the words used to describe an "arrangement" in s YA 1 all appear to be slightly different concepts.

29. The courts have not considered the definition of "arrangement" in the context of s CX 2(2), nor have they considered the application of s CX 2(2) in its entirety. However, the courts have considered the definition of "arrangement" contained in s YA 1 in the context of the general anti-avoidance rule in s BG 1.

30. The predecessor to the s YA 1 definition was discussed by Richardson P in *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA). His Honour considered the definition of "arrangement" in s 99(1) of the Income Tax Act 1976 at [45] as follows:

> The words contract, agreement, plan and understanding appear to be in descending order of formality. A contract is more formal than an agreement, and in ordinary usage is usually written while an agreement is generally more formal than a plan, and a plan more formal or more structured than an understanding. And it is accepted in the definition of arrangement that the contract, agreement, plan or understanding need not be enforceable. Section 99 thus contemplates arrangements which are binding only in honour.

31. Richardson P cited with approval the statement by the High Court of Australia in *Bell v FCT* (1953) 87 CLR 548, 573 that "arrangement" in an earlier Australian general anti avoidance provision extended beyond contracts and agreements "so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect" (at [46]). His Honour noted that statements to similar effect were made in *Newton v Commissioner of Taxation* [1958] AC 450, 465 (PC), where Lord Denning stated that the word "arrangement" under the then Australian general anti-avoidance provision:

> … is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may not be enforceable at law.

32. The definition of "arrangement" in s 99(1) of the 1976 Act, considered by Richardson P in *BNZ Investments*, differs from the definition of "arrangement" in s YA 1. The order of the words has been changed to be listed alphabetically in the 2007 Act (ie, "agreement" precedes "contract"). Despite this, the same observation can be made that the inclusion of the words "agreement, contract, plan, or understanding" mean that "arrangement" provides for varying degrees of enforceability and formality. As defined in s YA 1, an "arrangement" may be a legally enforceable contract, a less formal agreement or plan that may or may not be legally enforceable, or an informal, unenforceable understanding. Accordingly, "arrangement" is defined widely to include all kinds of concerted action by which persons seek to bring about the fulfilment of a particular purpose or the production of a particular effect. It includes agreements, contracts, plans or understandings that are not intended to be legally binding, and arrangements that are unenforceable

at law, for example, contracts unenforceable due to reasons of public policy, contractual incapacity or illegality.

33. In the context of s BG 1, the courts have considered whether "arrangement" requires a consensus or meeting of minds. This issue was considered by the Court of Appeal in *BNZ Investments*. In that decision, Thomas J dissented, holding that no such requirement existed. His Honour held that "arrangement" does not require that one party knew of, or agreed to, all the steps and transactions undertaken by the other party to discharge its obligations under the "agreement, contract, plan or understanding". Thomas J's approach was later endorsed by the majority of the Privy Council in *Peterson v CIR* (2005) 22 NZTC 19,098 (at [34]).

34. However, in s CX 2(2), an "arrangement" is qualified by the words "made between their employer and another person for the benefit to be provided". As will be discussed, these words mean that s CX 2(2) applies only if the employer's purpose or object in making the arrangement is for a benefit to be provided to an employee (see [66]–[71] below). For this purpose or object to exist, the employer must have authorised the third party to provide a benefit to an employee.

35. The case law on the meaning of "arrangement" as used in commerce-related legislation (for example, the Commerce Act 1986) is also useful. This case law makes clear the following:

- An "arrangement" exists where each party intentionally creates in the other party an expectation that the first party will act in a certain way. In so doing, the parties agree to mutual rights and obligations in respect of the course of action to be undertaken.
- An "arrangement" is unlikely to exist when only one party makes a commitment to the proposed course of action.

(See *Apple Fields Ltd v New Zealand Apple and Pear Marketing Board* [1991] 1 NZLR 257 (PC); *Re British Basic Slag Ltd's Agreements* [1963] 2 All ER 807 (CA); *Trade Practices Commission v Email Ltd* (1980) 31 ALR 53 (FCA).)

36. In the context of s CX 2(2), "arrangement" will include situations where the employer arranges with the third party to provide a benefit, where the employer agrees to allow the third party to approach an employee, or where the employer agrees to allow an employee to join a scheme promoted by the third party. Where this type of significant contact does not occur, the parties will not have entered into an arrangement for the purposes of s CX 2(2).

37. However, for an "arrangement" to be caught under s CX 2(2), it must be an arrangement "for" a benefit to be "provided" to an employee. This means that not every "arrangement" that exists between an employer and a third party will be caught by s CX 2(2). Similarly, not every instance where a benefit is provided to an employee by a person who is not their employer will be caught by the section.

What is the meaning of "for"?

38. Section CX 2(2) provides that the "arrangement" made between the employer and another party be "for" the benefit to be provided.

39. The word "for" can have a wide variety of meanings depending on its context. The Court of Appeal in *Wilson & Horton v CIR* (1995) 17 NZTC 12,325 stated at 12,330:

> Reference to any standard dictionary brings home the wide variety of senses in which the preposition "for" may be employed. The Oxford English Dictionary (2nd ed) identifies 11 separate categories of meaning and many distinct usages within particular categories. The discussion in the text extends over 9 columns in the dictionary. Again the Tasman Dictionary, which as its name suggests is directed to Australian English and New Zealand English, lists 33 meanings of the word. **The particular meaning intended necessarily hinges on the context in which the word is used and how it is used in that context.**
>
> [Emphasis added]

40. The use of the word "for" was interpreted in *Patrick Harrison & Co v AG for Manitoba* [1967] SCR 274 (CASCC) as imposing a purpose test. In this case, the court held that "for the extraction of minerals" meant "with the object or purpose of extracting minerals".

41. In *G v CIR* [1961] NZLR 994 (SC), McCarthy J held that the word "for" points to intention, which is similar to looking at a person's purpose. McCarthy J stated at 999:

> "For" points to intention ... the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word "for", when considering a phrase such as "carried on for pecuniary profit" used in relation to an occupation, as importing intention.

42. These cases show that in several statutory contexts the courts have interpreted "for" to mean "for the purpose" or "with the object of" something. It is noted that, in this context, a person's purpose is similar to their intention. However, to determine the meaning of "for" in s CX 2(2), the rest of the wording must be looked at.

43. As already noted, s CX 2(2) requires the benefit to be provided to the employee through an arrangement made between the employer and another person "for" the benefit to be provided. The use of "for" in this context can mean that the "arrangement" must have been made "for" the provision of a benefit to an employee.

44. In the Commissioner's opinion, based on the case law and dictionary definitions, an "arrangement" will satisfy s CX 2(2) if it is made "for the purpose" or "with the object" of providing such a benefit to an employee.

Purpose of the arrangement or purpose of the parties?

45. Given that the words "for the benefit to be provided" mean for the purpose or with the object of providing the benefit, the issue arises as to who or what must have this purpose or object. This requires interpreting the words "an arrangement made between their employer and another person for the benefit to be provided".

46. There are two possible interpretations of these words:

- First, "for the benefit to be provided" could be read as relating to the word "arrangement". Under this interpretation, s CX 2(2) applies if the **arrangement** has the purpose or object of providing a benefit to an employee of the employer. This would require an objective inquiry into the arrangement itself, and would not consider the purpose or object of the parties to the arrangement.
- Second, "for the benefit to be provided" could be read as relating to the word "made". Under this interpretation, s CX 2(2) applies if the purpose or object of **the parties in making the arrangement** was for a benefit to be provided to an employee of the employer.

47. Under the first interpretation, s CX 2(2) could have a wider scope than under the second interpretation. It could be possible that, objectively, an arrangement has the purpose or object of providing an employee of the employer with a benefit in circumstances where, subjectively, the parties did not make the arrangement for the purpose or object of providing a benefit to an employee.

48. The meaning of a section must be determined from its text and in the light of its purpose (s 5, Interpretation Act 1999). In determining purpose, the immediate and general legislative context must be considered, as well as the objective of the enactment (*Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36). Therefore, the purpose of s CX 2(2) must be considered to determine the best interpretation.

49. An argument favouring the first interpretation of s CX 2(2) above, is that this interpretation is consistent with s BG 1. Under s BG 1, only the objective purpose or effect of the "arrangement", and not the intention of the parties to the arrangement, is relevant to whether there is a "tax avoidance arrangement" (*Newton v FCT; Glenharrow Holdings Ltd v CIR* [2008] NZSC 116; *Ben Nevis Forestry Ventures v CIR, Accent Management v CIR* [2008] NZSC 115). Arguably, it is appropriate that s CX 2(2) is interpreted consistently with s BG 1, given they both have an anti-avoidance purpose and share the same definition of "arrangement".

50. However, the second interpretation, requiring consideration of the purpose or object of the parties, could be seen as consistent with the FBT rules. The FBT rules apply where there is a "fringe benefit", which is defined in s CX 2(1)(a) as being a benefit that "is provided by an employer to an employee in connection with their employment". This indicates that the focus of the FBT rules is on benefits that the employer has chosen to give its employees. Understood in this way, the purpose of s CX 2(2) appears to be to prevent employers from deliberately avoiding a liability for FBT by arranging for a third party to provide the benefit instead.

51. The second interpretation is not inconsistent with s BG 1. Unlike s CX 2(2), the wording in s BG 1 is unambiguous in requiring consideration of the purpose or effect of the arrangement.

52. Moreover, the first interpretation, requiring consideration of the purpose or object of the arrangement, arguably creates the potential for overlap with s GB 31. Section GB 31 provides an anti-avoidance rule that applies when "a purpose or effect of the arrangement [entered into by two or more persons] is to defeat the intent and application of any of the FBT rules". Section CX 2(5)(a) provides that a benefit may be treated as having been provided by an employer to an employee under s GB 31.

53. Section GB 31(1) is clear that it concerns the purpose or effect of the arrangement and not the purpose or object of the parties to the arrangement. If the drafters had intended the purpose or object of the arrangement to be relevant under s CX 2(2), it would be reasonable to expect that the drafters would have adopted language similar to that used in ss BG 1 and GB 31.

54. The background to s 336N(2) of the Income Tax Act 1976, the earliest predecessor to s CX 2(2), also provides some assistance in understanding the purpose of s CX 2(2) and the FBT rules generally.

55. The FBT rules were enacted in light of the recommendations in the *Report of the Task Force on Tax Reform* (Wellington, Government Printer, 1982) (the McCaw report). Before the enactment of the FBT rules, fringe benefits were generally not taxed. The McCaw report considered that the non-taxable status of fringe benefits was unsatisfactory because it increased the inequity in the tax system and narrowed the tax base (at [6.185]).

56. In the third reading debate of the Income Tax Amendment Bill (No 2), which introduced the FBT rules, the Minister of Finance stated that the purpose of fringe benefit tax was to "close … off loopholes that are a major source of unfairness in income distribution", and that ((22 March 1985) 462 NZPD 3920):

> In the Government's view it is fair to tax the employers, the basic reason being that it is the employers which have been using fringe benefit payments to lower the cost structures of their business. I gave the example in the Committee of an employer who might want to put together a package of $100,000. He could pay $40,000 in terms of salary, then put together a fringe benefit package of about $20,000 in various forms, which was the equivalent of tax paid income of $60,000. In other words, for $60,000 in terms of cost structure to the business the employer was able to put together a salary package equivalent of $100,000. In those circumstances the Government believes it is fair and equitable to tax the employer.

57. The Minister of Finance's speech indicates that the mischief Parliament sought to remedy by enacting the FBT rules was the ability of employers to decrease the costs of employment by substituting assessable income with non-assessable fringe benefits. While the Minister did not specifically discuss the clause of the Bill that became s 336N(2) of the Income Tax Act 1976, his comments suggest that s 336N(2) was intended to cover the specific situation of an employer that knowingly seeks to avoid a liability for FBT by arranging for a benefit to be provided to an employee by a third party.

58. Therefore, the Commissioner's view is that the scheme of the FBT rules and the legislative history suggest that s CX 2(2) requires the determination of the purpose or object of the parties (that is, the employer and the third party) in making the arrangement.

Which party's purpose?

59. It is the parties' purpose or object in making the arrangement that is relevant. Where both the employer and third party share the same purpose, then determining whether s CX 2(2) applies will be straightforward. However, in some situations the employer and third party may each have a different purpose or object in making the arrangement.

60. For example, where the third party agrees to provide the benefit because the employer has stated it will withhold business from the third party unless it does so, arguably the third party has not made the arrangement for the purpose or with the object of providing a benefit to an employee. Instead, the third party arguably made the arrangement for the purpose or with the object of preserving its business with the employer. The issue then arises as to whose purpose should be considered determinative when deciding whether s CX 2(2) applies.

61. The Commissioner's view is that the scheme of the FBT rules supports the employer's purpose being determinative in these situations.

62. A liability for FBT is imposed on benefits provided by employers to their employees. The FBT rules are not, as a rule, concerned with benefits provided to employees by persons who are not their employers. Section CX 2(2) is an exception to this rule. Section CX 2(2) has an anti-avoidance purpose. It seeks to prevent employers from avoiding a liability for FBT by arranging for third parties to provide benefits to their employees.

63. The scheme of the FBT rules supports s CX 2(2) applying where the employer, but not the third party, makes the arrangement with the purpose of providing a benefit to an employee. In such cases, a liability for FBT is avoided where it would have arisen if the benefit had instead been provided by the employer directly. Moreover, the third party is not seeking to avoid its liability for FBT, because it has no liability. At most, the third party might be a knowing participant in the employer's arrangement. More likely, perhaps, the third party would be pursuing their own commercial non-tax objectives and may be ignorant of, or indifferent to, the employer's purpose.

64. By contrast, the scheme of the FBT rules does not support s CX 2(2) applying where the third party, but not the employer, makes the arrangement with the purpose of providing a benefit to an employee. If s CX 2(2) were to apply in such cases because of the third party's purpose, then FBT would be imposed despite the employer not having the purpose of providing a benefit to its employee. The imposition of FBT in these circumstances seems unfair and illogical.

65. In summary, where the employer and the third party each have a different purpose or object in making the arrangement, s CX 2(2) will apply only if the employer's

purpose or object in making the arrangement was to provide a benefit to an employee.

Objective or subjective test?

66. The above conclusions combine to show that, for an "arrangement" to be caught under s CX 2(2), the purpose or object of the employer must have been to provide the employee with a benefit. This part of the commentary considers whether the test should be a subjective or an objective one.

67. In the current context, a subjective test would look at what the particular employer had in mind when the arrangement with the third party was entered into. An objective test, however, would consider what a reasonable person in the position of the employer should have had in mind.

68. Case law, particularly in the area of GST, indicates that the correct test for determining purpose is a mixed test, considering both subjective and objective factors in reaching a conclusion as to a taxpayer's purpose. In several cases, the courts have held that the test for purpose is dependent on the statutory context in which it is found (see, for example, *CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).

69. Therefore, the wording of s CX 2(2) must be looked at closely. Section CX 2(2) does not contain the word "purpose" or "object". It requires that the "arrangement" be "made between" the employer and the third party "for the benefit to be provided".

70. The Commissioner's view is that s CX 2(2) requires a consideration of the reason the employer "made" the "arrangement" with the third party. This means the test to determine the employer's purpose or object in making the arrangement should be subjective, looking at the particular reasons the employer had in mind (see, for example, *G v CIR*). However, the employer's reasons should be tested in light of the surrounding circumstances (*CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA)).

71. For s CX 2(2) to apply, therefore, the reason the employer made the arrangement must have been to provide a benefit to its employee.

Which purpose test should be applied?

72. A number of tests could be used to determine the purpose or object of the employer in making the arrangement with the third party.

73. At one end of the spectrum is a sole purpose test. This test requires that the provision of a benefit to an employee is the sole or only purpose of the employer in making the arrangement. The Commissioner considers this would be an unduly restrictive test for s CX 2(2) because it would not apply in any situation where another purpose existed, no matter how secondary or minor.

74. At the other end of the spectrum, is the test that the section will apply if any one of the purposes of the employer in making the arrangement is that the employee be provided with a benefit. The Commissioner considers this is also an inappropriate test in the context of s CX 2(2). This is because the section would catch all benefits that were provided to employees even if the employer had only an incidental relevant purpose. If the provision of the benefit is truly incidental to the purpose of the employer, then the section should not apply.

75. Between these two extremes are the dominant purpose test and the more than incidental purpose test.

76. The dominant purpose test would require that the main reason the employer made the arrangement with the third party was for the benefit to be provided to the employee. This test would allow the employer to have other purposes in making the arrangement but, for the section to apply, the main purpose of the employer in making the "arrangement" needs to be the provision of the benefit.

77. Several cases have determined that the word "purpose" used on its own in statutory language without any apparent qualifier means the dominant purpose of the taxpayer; for example, in s CB 4 (Personal property acquired for the purpose of disposal) (and predecessor provisions) and in s 108 of the Land and Income Tax Act 1954 (the former s BG 1).

78. The Commissioner considers it would not be appropriate to apply a dominant purpose test in determining whether s CX 2(2) applies. The words of s CX 2(2) do not indicate that a dominant purpose test is necessary. This can be contrasted with s CB 4, where the section clearly refers to "**the** purpose" [emphasis added].

79. The final option is a more than incidental purpose test. This test would be similar to the test applied for s BG 1, where the section will apply as long as the purpose of tax avoidance is more than merely incidental to any other purpose in entering the arrangement. In the context of s CX 2(2), this means that if the provision of the benefit is incidental to other purposes of the "arrangement", such as the provision of credit cards to employees or obtaining a good package deal for the employer, then the section would not apply.

80. The use of this test could be seen as supported by s CX 2(2) being an anti-avoidance provision and

it being appropriate to have a similar test to other avoidance provisions. Alternatively, it could be argued that a more than incidental test is not appropriate, because the language of s BG 1 explicitly provides for the test of more than merely incidental in the legislation itself, whereas s CX 2(2) does not.

81. Overall, the Commissioner considers that the more than incidental test is the appropriate test to be adopted in s CX 2(2). A more than incidental test means that the purpose of the employer must be significant in order for the benefit to be caught within the section, but does not need to be the most important (or dominant) reason or purpose of the employer in making the "arrangement".

82. If an employer has more than one purpose when they made the "arrangement" with the third party, a significant, but not dominant, purpose of providing a benefit to employees should be caught by the section. If, however, the provision of a benefit is no more than incidental to some other purpose of the employer in making the arrangement with the third party, then s CX 2(2) will not apply.

83. In determining the employer's purpose or object, therefore, the relevant consideration is the subjective purpose or object of the employer in making the "arrangement". For s CX 2(2) to apply, the employer must have, at least, a more than incidental purpose or object of providing a benefit to an employee in making the arrangement.

Can s CX 2(2) apply where there is an employee–third party arrangement?

84. In some cases, where a benefit is provided to an employee by a third party, it might be argued that there are two arrangements "for" that benefit to be provided—one arrangement between the employer and third party and another between the employee and third party. In such cases, the issue may arise whether the presence of an arrangement between the employee and third party for the provision of a benefit means that same benefit cannot have been provided under an arrangement between the employer and third party.

85. For instance, an employer makes an arrangement with a local gym under which the gym agrees to provide free membership to the employer's employees. To obtain this free membership, employees must undertake the gym's membership process (including agreeing to its standard terms and conditions of use). In this situation, it might be argued that s CX 2(2) cannot apply because the gym membership has been provided through an arrangement between the gym and the employee and, therefore, not through the arrangement between the employer and the gym.

86. The Commissioner's view is that an employee–third party arrangement for a benefit to be provided does not prevent the same benefit from being provided through an employer–third party arrangement to which s CX 2(2) applies. Section CX 2(2) does not expressly or implicitly exclude itself from applying because the benefit concerned may also have been provided through an employee–third party arrangement. Accordingly, s CX 2(2) may apply even if the benefit may also have been provided through an employee–third party arrangement.

What is the meaning of "benefit"?

87. As noted above, a fringe benefit is defined in s CX 2(1) as "a benefit that … is provided by an employer to an employee in connection with their employment".

88. The term "benefit" is not defined in the Act. Therefore, the ordinary meaning of the word must be considered. The *Concise Oxford Dictionary* relevantly defines the word "benefit" to mean "an advantage or profit gained from something." The meaning of "benefit" is, therefore, very wide.

89. In *Case M9* (1990) 12 NZTC 2,069, Bathgate DCJ considered the meaning of the word "benefit" when considering whether the provision of a motor vehicle was subject to FBT. He stated at 2,074:

> A feature of the definition of "fringe benefit" is the rather involved detail used to specify what is a fringe benefit and what is not a fringe benefit, particularly the latter. A "fringe benefit" is however a "benefit", including the availability for the private use or enjoyment of any person of a motor vehicle, as defined. **The section itself to an extent explains what is a benefit, for the purposes of a fringe benefit; so long as something is provided by an employer to an employee that can be reasonably, practically and sensibly understood as a benefit to the employee in itself and is not expressly excluded, would be sufficient for it to be a benefit for the purposes of the definition of "fringe benefit"** as provided by the section.
>
> [Emphasis added]

90. While the legislative provision considered in *Case M9* was a predecessor to s CX 2, the principles remain relevant as the definition of "fringe benefit" still requires that a benefit be provided by an employer to an employee.

91. Based on *Case M9*, a "benefit" is something provided by an employer that can be "reasonably, practically and sensibly understood as a benefit to the employee". Whether a fringe benefit is provided does not depend on whether employees consider that they have

received an advantage or benefit. This conclusion is consistent with the analysis on the meaning of "benefit" in QB 12/06 "Fringe benefit tax – 'Availability' benefits" (*Tax Information Bulletin* Vol 24, No 4 (May 2012): 32).

92. Further assistance as to the meaning of the term "benefit" can be obtained from a review of the purpose of the FBT rules. The purpose of the rules can be ascertained from the McCaw report which recommended the introduction of FBT.

93. In setting out the case for taxing fringe benefits, the report states at [6.181] to [6.182]:

> Fringe benefits do not, under existing legislation, generally represent assessable income of the recipient. Some benefits provided in kind, such as accommodation and food, are assessable in terms of the existing tax law. The courts have held that other benefits provided in kind are not assessable unless they can be converted into cash by the recipient. Cash payments are assessable except to the extent that they can be demonstrated to be reimbursement of expenses incurred in gaining or producing assessable income. The Task Force does not consider that such reimbursement allowances constitute a fringe benefit and therefore does not propose any change to the current tax exempt status.
>
> ...
>
> **Fringe benefits that reduce an employee's need to meet private outgoings from income clearly increase a taxpayer's capacity to pay in just the same way as does the payment of additional salary or wages in cash.** Those who receive part of their remuneration in this form do not bear their fair share of the tax burden. Furthermore employers who provide non-taxable benefits in lieu of salary or wages are in a favoured position as their total labour cost is reduced.
>
> [Emphasis added]

94. From this, it can be seen that fringe benefits are benefits that provide an economic advantage to an employee because they reduce an employee's need to meet private expenditure from their income. In economic terms, benefits of this type are equivalent to the payment of additional salary or wages in money to the employee.

95. The meaning of "benefit" was also considered in *Case M59* (1990) 12 NZTC 2,339. In *Case M59* Bathgate DCJ stated at 2,343:

> The fringe benefit by way of the provision of the overseas travel and accommodation was provided by the objectors as the employers before 1 April 1985, when they paid the costs of the employees' proposed travel with the travel agents or firms consulted by the employees. Although that benefit may not have been used or enjoyed by the employees until after 1 April 1985, that was not, in my view, a "fringe benefit", because **a fringe benefit as defined by the Act requires two steps and not just one, namely the provision of the benefit by the employer and the use or enjoyment of the benefit by the employee**. The enjoyment of the fact of travel by the employees may well be a benefit, but without the provision of that by the employer it is not a "fringe benefit" for FBT purposes.
>
> [Emphasis added]

96. However, *Case M59* was considered in the context of the language used in the Income Tax Act 1976, which defined "fringe benefit" as a "benefit that is used, enjoyed, or received ...". The rewritten definition of "fringe benefit" does not include any element of use or enjoyment (by the employee of the benefit provided). In terms of the rewritten definition, all that is required is that the employer has provided a benefit to an employee.

97. Given that s CX 2(2) is an anti-avoidance provision, and essentially treats a benefit provided by a third party to be a fringe benefit provided by an employer, a further issue exists as to whether what the employee receives from the third party needs to be a benefit that the public is unable to receive.

98. The Commissioner considers that, given the conclusion as to the broad meaning of the term "benefit", a fringe benefit can include something the employee could receive on their own account, or that the public could receive. This conclusion is consistent with "The meaning of 'benefit' for FBT purposes" (*Tax Information Bulletin* Vol 18, No 2 (March 2006): 26), which considers whether an employer provides a benefit where an employee pays for goods or services obtained from their employer, or where the employer also benefits from the employee's receipt of the goods or services.

What is the meaning of "provided"?

99. Section CX 2(2) requires that a benefit be "provided to an employee through an arrangement". For a benefit to be caught under s CX 2(2), the third party must provide it to the employee. An "arrangement" between the parties for access to the employees is insufficient. The "arrangement" must be for the "provision" of a benefit for s CX 2(2) to apply.

100. The *Concise Oxford English Dictionary* defines the term "provide" as "make available for use; supply".

101. Several cases have discussed the meaning of the word "provide". These cases show that the meaning of "provide" depends on the facts and circumstances of each case (see for example *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414 (QBD) at 422).

102. In *Norris v Syndi Manufacturing Co Ltd* [1952] 1 All ER 935 (CA), an employee had removed the safety guard from a machine to carry out tests. His employer was aware that the employee took the guard off to test the machine and had told him to replace it "after testing and before operation". The employee inadvertently injured himself while working without the guard one day. The Court of Appeal found that the guard had been "provided" by the employer, and that the duty to provide the guard did not require that the employer should have to order the workers to use it. Romer LJ stated at 940:

> **The primary meaning of the word "provide" is to "furnish" or "supply"**, and, accordingly, on the plain, ordinary interpretation of s. 119 (1), a workman's statutory obligation is to use safety devices which are furnished or supplied for his use by his employers.
>
> [Emphasis added]

103. See also *Tranz Rail Ltd (TIA Interisland Line) v New Zealand Seafarers' Union* [1996] 1 ERNZ 216 (EC), and *Pierce v FCT* 98 ATC 2240 (AAAT).

104. Accordingly, for something to have been "provided" to an employee by a third party in the context of s CX 2(2), it must be supplied, furnished, or made available to that employee.

Salary sacrifice situations

105. This Ruling does not consider or rule on the taxation implications of salary sacrifice situations. Different considerations may apply to determine the tax treatment. For example, the benefit may have been provided by the employer in such a situation, or there may be other relevant aspects of the arrangement. These considerations may affect whether or not s CX 2(2) will have any application.

106. In the context of the Ruling, salary sacrifice situations include situations where the remuneration given by an employer to an employee is reduced because of a benefit being received by the employee from a third party (or because of the possibility of a benefit being received), or where the remuneration of the employee otherwise takes the receipt of a benefit provided by a third party into account.

Examples

107. The following examples are included to assist in explaining the application of the law. They consider whether the requirements of s CX 2(2) are satisfied. The examples do not consider whether FBT will be payable on a benefit provided through an arrangement to which s CX 2(2) applies. Section CX 2(2) may apply but FBT will not be payable because of the other provisions in subpart CX or the operation of the valuation rules contained in subpart RD.

108. These examples all assume that there has been no sacrifice of salary by the employee receiving the benefit.

Example 1

109. ABC Bank wishes to offer the employees of XYZ Ltd a low interest loan facility. ABC approaches XYZ, which agrees to ABC's offer and agrees to pay ABC the difference between the interest rate offered to employees and the current market interest rate.

110. On the facts of this example, the requirements of s CX 2(2) are clearly satisfied. An "arrangement" exists between ABC and XYZ, and the purpose of the employer in making the arrangement is for the provision of a benefit to XYZ's employees. This is evidenced by the fact consideration has been passed between the employer and the third party for the benefit being provided.

Example 2

111. A credit card company approaches the manager of BCE Ltd, and asks whether BCE would allow it to approach BCE's employees to offer them credit cards (for the employees' personal use). The credit card company proposes that all staff members who choose to receive cards would be allowed to join the credit card company's loyalty scheme (which has no joining fee, but is available only to selected cardholders). BCE agrees to this request, but suggests that the credit card company might wish to provide a slightly discounted interest rate to the employees, so that the offer does not waste the employees' time. The credit card company agrees to this change. BCE provides no consideration to the credit card company. The credit card company is keen to secure BCE employees as customers and is happy to agree to offer the employees the additional benefits.

112. In this example, there is an "arrangement" between the employer and the third party. BCE and the credit card company have agreed to the credit card company undertaking a particular course of action. However, s CX 2(2) will not apply in this situation. The agreement does not include the provision of a benefit, but merely allows the credit card company access to BCE's employees to offer them a benefit. The main purpose of BCE in entering into the arrangement is to allow the credit card company to offer a benefit to BCE's employees that will be of potential interest to the employees. The

provision of a benefit, if it is a purpose of BCE, will be incidental to this. Therefore, s CX 2(2) will not apply to this arrangement.

Example 3

113. A local retailer approaches MNO Ltd and asks permission to display advertising brochures on MNO's premises and for MNO to place an advertisement on the company's intranet. After a cursory inspection of the brochures and advertisement, MNO agrees. MNO also agrees to allow the retailer to email interested staff with updated specials (staff are given the opportunity not to receive the email updates). The brochures and subsequent email messages invite the employees to join a loyalty programme, which gives them the possibility of receiving rewards.

114. In this example, there will be an "arrangement" between MNO and the local retailer, as they have agreed on a future course of action. However, the arrangement will not be "for" the provision of a benefit. MNO has agreed only to allow the local retailer access to its employees, and this is its main purpose in entering into the arrangement. Any purpose MNO may have of benefiting its employees is incidental to this purpose. The "arrangement" is "for" access to MNO's premises or to allow the local retailer to communicate with the employees directly or by electronic means, not to provide a benefit to employees. Therefore, s CX 2(2) will not apply to this arrangement.

Example 4

115. BB Ltd is a large company with several high net worth employees. BB contacts its bank and asks the bank to offer a low interest mortgage facility to BB's employees, which would also permit employees to obtain a mortgage with a smaller deposit than would usually be required. BB believes the bank will agree to this request because BB has a lot of business with the bank. Additionally, it is expected that the bank will get a great deal of business from the employees of BB, because BB has told the bank it is aware of a reasonable number of staff members who would be interested in such a facility. The bank is attracted by the level of business it might achieve with the employees and is also keen to maintain the good relationship it has with BB, so it puts together a proposal, which it presents to BB. BB considers that the proposal is worthwhile, so asks the bank to make the facility available to employees. BB also agrees to help promote the facility by putting up posters and making brochures available in the workplace, and by sending an email message to staff informing them of the facility.

116. In this example, there is an "arrangement" between BB and the bank that is "for" the provision of a benefit to employees. The course of action agreed to by the parties involves the provision of a benefit to employees. BB has not simply entered into the arrangement with the purpose of allowing the bank access to the employees. Rather, BB has entered into the arrangement with a more than incidental purpose of providing employees with a benefit. This is evidenced by the fact BB has an expectation that the bank would comply with its request and because it is aware of staff members who would be interested in the facility. Therefore, s CX 2(2) will apply to this arrangement.

Example 5

117. STU Ltd and VWX Ltd are companies in the same group of companies. The group has a widely understood policy that all companies in the group will provide discounted products or services to all employees of companies in the group, although this policy has never been put into writing. STU, therefore, provides interested VWX employees with discounts on its products.

118. In this example, there will be an "arrangement" for the provision of a benefit, and VWX will be liable to FBT on any benefits received by its employees from STU. There is a group policy that each company will provide the employees of the other companies in the group with benefits. Therefore, there is an understanding between VWX and STU that each will act in a particular way, that understanding extending to the provision of a benefit, and the purpose of the policy is to allow employees to be provided with benefits by STU. Therefore, s CX 2(2) will apply to this arrangement.

Example 6

119. DFG, a travel agent, employs several staff and enters into a scheme with YTR, an airline, to strengthen its relationship with YTR. The scheme involves YTR agreeing to give a certain number of free domestic flights per year to employees of DFG who excel in promoting and selling YTR flights. In return, DFG agrees to have its employees promote YTR flights and convert flights to YTR wherever possible. To determine which employees are entitled to free flights, DFG awards its staff with points for outstanding customer service. Once a staff

member has accumulated the required number of points, they are entitled to a free flight from YTR. There is no cost to DFG for those flights.

120. In this example, s CX 2(2) will apply. There is an "arrangement" between the parties, as the course of action agreed to by DFG and YTR involves the provision of a benefit to employees. One of the main purposes of DFG in entering into the arrangement is to provide the staff with free flights. Although DFG has another significant purpose in entering into the arrangement, which is to strengthen its relationship with YTR, the purpose of providing a benefit to employees is not incidental to that purpose.

Example 7

121. HJK is a large nationwide employer with many staff. A senior manager of HJK approaches LMN, a nationwide chain of retail stores, and suggests that LMN might like to consider offering a discount to HJK employees. LMN agrees to consider this idea and decides to allow a 10% discount to all HJK staff at all of its stores. This is achieved by providing all employees with a discount card. HJK does not give any consideration for this, has made no suggestion that it will do business with LMN if a discount is permitted, and has not been involved in discussions about the level of the discount or any other details of the offer. LMN has decided to offer the employees the discount because it believes LMN will obtain a substantial amount of business.

122. Section CX 2(2) will not apply in this situation. There is no "arrangement" between the parties that encompasses the provision of the benefit, as the only course of action agreed to by the parties is that LMN will consider the idea. HJK has done no more than initiate discussions with LMN, and the decision to offer a benefit to employees was made unilaterally by LMN. Although the purpose of HJK could be argued to be the provision of a benefit, there is no "arrangement" with LMN that is "for" such provision.

Example 8

123. An employee works for a company. She obtains a personal credit card and joins its associated points reward scheme. Under that scheme, she can accumulate points as goods and services are charged on the credit card. After the employee accumulates 10,000 points, she can transfer those points, at her option, to any one of several airlines' frequent flyer schemes affiliated to the credit card company's points reward scheme. Once she accumulates a specified number of points on the airline frequent flyer scheme, she can exchange them for free or discounted travel.

124. In the course of the employee's work, she incurs several employment-related charges on the credit card as well as private expenditure. The employee accumulates points on the credit card points reward scheme for both types of expenditure. She soon reaches the specified threshold of points and transfers them to a particular airline's frequent flyer scheme, exchanging them for a free trip to Fiji.

125. Section CX 2(2) will not apply on the facts of this example. The receipt of the points under the credit card company's points reward scheme is because of the contractual arrangement between the credit card company and the employee. There has been no significant contact between the employer and the credit card company. No arrangement exists between the employer and the credit card company to provide the employee with entitlements under its points reward scheme or the associated airline's frequent flyer scheme. It does not matter that some of the points that give the entitlement result from employment-related expenditure.

Example 9

126. Following from example 8, in the following year the employee is promoted in the company and receives a corporate charge card on which she is specified as the cardholder. The charge card is from a different company to that which issued her personal card. This particular charge card company also allows cardholders to join its points reward scheme. The employee joins the points reward scheme as an individual member and pays the membership fee personally. The employee's employer is not involved in encouraging the employee to join the scheme. This scheme also allows an accumulation of points as goods and services are charged on the card and a transfer of points, subject to certain conditions, to a participating airline's frequent flyer scheme.

127. Section CX 2(2) will not apply on the facts of this example. There has been no significant contact between the employer and the credit card company. There is no arrangement between the employer and the credit card company to provide entitlements to the employee under the points reward scheme. The employee receives those entitlements because of her contractual relationship with the credit card company.

Example 10

128. QRS purchases motor vehicles for business purposes from a motor vehicle dealer. As a result of QRS' substantial custom, the dealer states that it will discount QRS' future purchases. It also informs QRS that the more vehicles purchased, the greater the discount. To increase the discount, QRS asks the dealer to offer the same discount to the employees of QRS. QRS tells the dealer that many of its employees would like to purchase vehicles and it expects that they would be induced to buy vehicles from the dealer if they were offered the same discount. The dealer agrees to offer the employees the same discount as it provides to QRS.

129. In this example, QRS has requested that the dealer provide its employees with a discount on any vehicles they purchase. Because of QRS' substantial custom, the dealer agreed to offer the discount to the employees. There is an arrangement between the dealer and QRS that is for the provision of a benefit (ie the discount) to the employees. Although the dominant purpose of QRS may be to obtain a higher discount on its future vehicle purchases, a significant purpose of it entering into the arrangement is so that the same discount is offered to its employees. Therefore, s CX 2(2) will apply, because QRS made the arrangement with a more than incidental purpose to provide its employees with a benefit.

References

Expired Rulings
BR Pub 04/05 "The provision of benefits by third parties: fringe benefit tax (FBT) consequences – section CI 2(1)" *Tax Information Bulletin* Vol 16, No 5 (June 2004): 4
BR Pub 09/07 "Provision of benefits by third parties – fringe benefit tax consequences – section CX 2(2)" *Tax Information Bulletin* Vol 21, No 7 (September 2009): 7
Subject references
Arrangement; Benefit; Fringe benefit tax; For; Provided; Third party provides benefit
Legislative references
Income Tax Act 1976 – ss 99 and 336N(2)
Income Tax Act 2007 – ss BG 1, CX 2(1), CX 2(2), CX 2(5)(a), GB 31 and the definition of "arrangement" in s YA 1
Interpretation Act 1999 – s 5
Case references
Apple Fields Ltd v New Zealand Apple and Pear Marketing Board [1991] 1 NZLR 257 (PC)
Bell v FCT (1953) 87 CLR 548 (HCA)
Ben Nevis Forestry Ventures v CIR [2008] NZSC 115
Case M9 (1990) 12 NZTC 2,069
Case M59 (1990) 12 NZTC 2,339
CIR v BNZ Investments Ltd (2001) 20 NZTC 17,103 (CA)
CIR v Haenga (1985) 7 NZTC 5,198 (CA)
CIR v National Distributors Ltd (1989) 11 NZTC 6,346 (CA)
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Ginty v Belmont Building Supplies Ltd [1959] 1 All ER 414 (QBD)
Glenharrow Holdings Ltd v CIR [2008] NZSC 116
Newton v Commissioner of Taxation [1958] AC 450 (PC)
Norris v Syndi Manufacturing Co Ltd [1952] 1 All ER 935 (CA)
Patrick Harrison & Co v AG for Manitoba [1967] SCR 274 (CASCC)
Peterson v CIR (2005) 22 NZTC 19,098 (PC)
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Re British Basic Slag Ltd's Agreements [1963] 2 All ER 807 (CA)
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Tranz Rail Ltd (TIA Interisland Line) v New Zealand Seafarers' Union [1996] 1 ERNZ 216 (EC)
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Report of the Task Force on Tax Reform (Wellington, Government Printer, 1982)
"The meaning of 'benefit' for FBT purposes" *Tax Information Bulletin* Vol 18, No 2 (March 2006): 26

PRODUCT RULING BR PRD 14/10: NEW ZEALAND INCOME GUARANTEE LIMITED

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by New Zealand Income Guarantee Limited.

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CA 1, CD 3–CD 21, CW 4, CX 56B, HM 31, HM 34–HM 55 and YA 1.

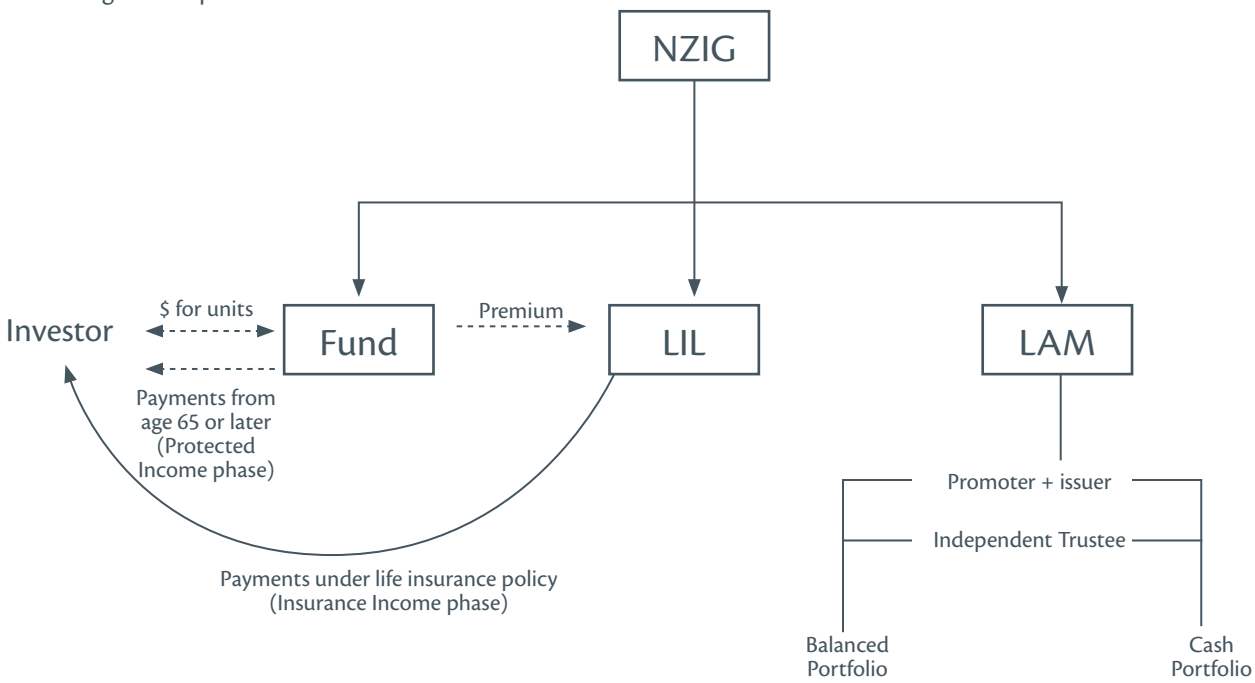
The Arrangement to which this Ruling applies

1. The Arrangement is the Lifetime Income product, which is a retirement product that provides a fund to invest accumulated KiwiSaver funds in return for a stream of regular payments over Investors' retirement lifetime. The payments will be set at a percentage of the Protected Income Base, being the original capital sum invested in the Fund net of any applicable fees and including any increase in value during the Investor's Deferral Period (the period up to the time the Investor begins receiving payments of the Lifetime Withdrawal Benefit) and will be made:
   - first, out of the capital invested by an Investor in the Lifetime Income Fund and the Investor's proportion of the Fund's post-tax earnings accumulated as a result of investing the original capital sum and;
   - second, from a life insurance policy or policies purchased by the Fund for the benefit of each individual Investor.
2. Further details of the Arrangement are set out in the paragraphs below.

Background

3. The parties to the Arrangement are:
   - *The Lifetime Income Fund (the Fund).* This is a unit trust registered under the Unit Trusts Act 1960. The Fund comprises two separate portfolios: the Balanced Portfolio and the Cash Portfolio. All investment activities are carried out through the Balanced Portfolio. The Fund's commitments are met from the Cash Portfolio. The trustee is the Public Trustee and the Custodian of the Fund is Public Trust and its bare trust nominee Public Trust (NZIG) Nominees Limited. The Fund will elect to be a portfolio investment entity (PIE) in accordance with s HM 71. The Fund will receive investments from members of the public.
   - *New Zealand Income Guarantee Limited (NZIG).* NZIG is a New Zealand incorporated company. NZIG is the parent company of the NZIG group and is 100% owner of Lifetime Asset Management Limited (LAM) and Lifetime Income Limited (LIL). NZIG will undertake general management for the group, including solvency and capital management.
   - *Lifetime Asset Management Limited (LAM).* LAM is a wholly owned subsidiary of NZIG and is a New Zealand incorporated company. LAM's function is to operate as an investment manager and as the manager of the Fund. It is the issuer and promoter of the Lifetime Income Fund for the purposes of the Securities Act 1978.
   - *Lifetime Income Limited (LIL).* LIL is a wholly owned subsidiary of NZIG and is a New Zealand incorporated company that is a licensed life insurer under s 17 of the Insurance (Prudential Supervision) Act 2010. LIL will receive insurance premiums from the Fund and provide Investors with cover under the Lifetime Withdrawal Benefit, Minimum Death Benefit and Spouse Benefit policies. LIL will not have reinsurance for the cover provided under the Arrangement.
   - *Investors.* These are members of the public who will invest in the Lifetime Income product by way of investing in the Fund and will in return be issued with units in the Balanced Portfolio. Investors' money will be pooled together and invested by the Fund in accordance with the Fund's investment strategy. From time to time the Fund will redeem Investors' units in the Balanced Portfolio and reinvest the proceeds in the Cash Portfolio to ensure there is adequate liquidity for the Fund to meet its commitments. Investors must be New Zealand citizens or individuals entitled to reside in New Zealand permanently and who are living (or normally living) in New Zealand. Investors can be aged up to 85 years old and must invest a minimum of $100,000 with the Fund (although this requirement may be waived at the Fund's discretion). Investors will supply an applicable prescribed investor rate (10.5%, 17.5% or 28%) to the Fund as appropriate.

4. The following diagram summarises how the Arrangement operates:



The Lifetime Income Fund

5. The overall product is the Lifetime Income Fund, in which members of the general public up to the age of 85 can invest their retirement savings (or a portion of them) built up through savings in a KiwiSaver scheme or otherwise. The Fund will manage the investment in a similar manner to a KiwiSaver scheme through the Balanced Portfolio, which will invest in low cost share and fixed interest index funds. The Fund will also manage distributions to provide income (the Lifetime Withdrawal Benefit) for the Investor over their retirement lifetime (from age 65 onwards). The Lifetime Income Fund will achieve this by purchasing a life insurance policy or policies in the name of the Trustee and for the benefit of Investors, along with offering an investment in a managed fund. The Cash Portfolio will be invested in cash and liquid fixed income investments. Premiums will be paid by the Fund manager to LIL annually by redeeming units held for an Investor in the Cash Portfolio. The amount of the premiums will be actuarially calculated based on factors specific to the Investor.

6. The Lifetime Withdrawal Benefit of the Investor is set at a percentage of their Protected Income Base, being the original capital sum invested in the Fund net of any applicable fees and including any increase in value during the Investor's Deferral Period (the period up to the time the Investor begins receiving payments of the Lifetime Withdrawal Benefit). The Investor may elect to commence receiving their Lifetime Withdrawal Benefit at any time from age 65 until age 85.

7. The Investor's Protected Income Base will rise during their Deferral Period (the period between when an Investor makes their initial investment and when they start receiving their Lifetime Withdrawal Benefit), as positive investment returns increase the value of their unitholding in the Fund. However, the Investor's Protected Income Base will not fall below the highest value reached before commencement of the payments of the Lifetime Withdrawal Benefit (or the original value of their investment, if this is higher).

8. Each year of deferral after the age of 65 increases the minimum Lifetime Withdrawal Benefit payment by 0.2%. For example, if an Investor takes the Lifetime Withdrawal Benefit immediately upon joining the Fund at age 65, they will receive minimum annual repayments of 5% of the original amount invested. If the Investor defers the commencement of the Lifetime Withdrawal Benefit for a year, the ongoing payments will be 5.2% of the Protected Income Base.

9. The Lifetime Withdrawal Benefit is comprised of two phases:

   - First, the Protected Income Phase: this phase commences on the date of the first payment of an Investor's Lifetime Withdrawal Benefit and ends when the Investor's balance in the Fund falls to zero.

Payments made during this phase are made by the Fund from the Investor's investment in the Fund, ie, the capital investment in the Fund and the Investor's share of the post-tax investment returns earned by the Fund. This is achieved by automatically redeeming the Investor's units in the Fund on an annual basis.

- Second, the Insured Income Phase: this phase commences after the Investor's balance in the Fund falls to zero. Payments made during this phase are made by LIL under the life insurance policy or policies purchased by the Fund from LIL directly to the Investor. If, for any reason, LIL does not make payments to an Investor under the policy, the Investor's income will cease accordingly, ie, the Fund has no liability to make payments to the Investor during this phase. Similarly, if LIL imposes any conditions limiting or affecting an amount payable under a policy, the Investor's income will be adjusted accordingly.

10. An Investor can choose between two options to take effect on their death at additional cost. First, they can choose for any remaining capital to be returned to the personal representative of their estate (the Minimum Death Benefit option). Alternatively, they can choose for their spouse to receive their Lifetime Withdrawal Benefit for the remainder of their spouse's life after their death (the Spouse Benefit option). Both of these benefits will be provided by LIL, with the Fund purchasing cover from LIL on behalf of the Investor.

Payments and withdrawals

11. The Fund will pay Investors their Lifetime Withdrawal Benefit fortnightly.

12. There will be flexibility for an Investor to withdraw their Fund balance (an Unplanned Withdrawal) but the Investor will be able to withdraw a minimum of 20% of their Fund balance at any time. This will first be used to reduce the balance of the Investor's capital investment and will reduce the base amount upon which the Investor's Lifetime Withdrawal Benefit from then on is calculated. If an Investor withdraws more than 20% of their Fund balance, their account will be closed and their entire remaining balance with the Fund returned to them.

13. In addition, if an Investor withdraws their investment within three years of their initial investment, an extra 1% of the original capital value will be payable by the Investor to the Fund over and above the transaction costs payable upon exit.

Fees and expenses

14. All fees, expenses and premiums payable by the Investor will be paid from the Investor's investment in the Cash Portfolio. Fees and expenses include transaction costs for monies invested or withdrawn, management fees, trustee's fees and early withdrawal fees.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

a) The continued application of private ruling BR Prv 14/82 (under s 91EB of the Tax Administration Act 1994).

How the Taxation Laws apply to the Arrangement

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

a) Investors' investment returns will be taxed at the Fund level at the appropriate prescribed investor tax rate under ss HM 31 and HM 34 to HM 55.

b) Payments from the Fund to Investors will be excluded income of the Investors under s CX 56B.

c) Any benefit to the Investor from the Fund arranging and meeting the costs of life insurance cover provided by LIL is not a dividend under ss CD 3 to CD 21 and is not income under s CA 1.

d) Payments under the Lifetime Withdrawal Benefit are exempt income of the Investor under s CW 4.

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

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2014 and ending on 31 March 2017.

This Ruling is signed by me on the 24th day of December 2014.

Howard Davis
Director (Taxpayer Rulings)

NEW LEGISLATION

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

ORDER IN COUNCIL

INCOME TAX (MINIMUM FAMILY TAX CREDIT) ORDER 2014

Section ME 1 of the Income Tax Act 2007

The Income Tax (Minimum Family Tax Credit) Order 2014, made on 17 November 2014, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from $22,776 to $23,036 a year and comes into force on 1 April 2015.

The order increases the prescribed amount in the definition in the formula for calculating the minimum family tax credit in section ME 1(3)(a) of the Income Tax Act 2007. It also revokes the Income Tax (Minimum Family Tax Credit) Order 2012 as it is now spent. The order amends the Income Tax (Minimum Family Tax Credit) Order 2013 to limit it to the 2014–15 tax year only.

Application date

The increase applies from the beginning of the 2015–16 tax year.

Income Tax (Minimum Family Tax Credit) Order 2014 (SR 2014/350)

LEGISLATION AND DETERMINATIONS

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

DETERMINATION FDR 2014/03: USE OF FAIR DIVIDEND RATE METHOD FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager, Investigations and Advice, under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the Harness Macro Currency Fund (the Harness Fund), to which this determination applies, are attributing interests in a foreign investment fund (FIF) for certain portfolio investment entity funds ("the NZFM Funds") managed by New Zealand Funds Management Limited.

The investments held by the Harness Fund, a sub-fund of CitiFirst Investments plc, are predominantly financial arrangements. In addition, the NZFM Funds hedge their attributing interests in the Harness Fund back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent the NZFM Funds from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

Despite the Harness Fund having assets predominantly comprising financial arrangements and the presence of the hedging arrangement, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument. Accordingly, I consider it is appropriate for the NZFM Funds to use the fair dividend rate method to calculate FIF income from its attributing interest in the Harness Fund.

Scope of determination

This determination applies to shares held by the NZFM Funds in the Harness Fund, a sub-fund of CitiFirst Investments plc.

CitiFirst Investments plc:

- is organised under the laws of Ireland as a limited liability company;
- is authorised by the Central Bank of Ireland;
- is an umbrella, open-ended investment company;
- has variable capital;
- invests in and trades in global currency markets and foreign exchange related derivatives through a total return swap with Citi bank Global Markets Limited.

The Harness Fund is a sub-fund of CitiFirst Investments plc and indirectly invests in trades in global currency markets and foreign exchange related derivatives, primarily through a total return swap.

The NZFM Funds will hedge their attributing interests in the Harness Fund back to New Zealand Dollars.

This determination is made subject to the following conditions:

1. That the investment in the Harness Fund is not part of an overall arrangement that seeks to provide NZFM Funds with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.
2. That the total value of exposures to foreign exchange related derivatives through a total return swap with Citibank Global Markets Limited will be more than 20% of the total asset value of the Harness Macro Currency Fund. If an event occurs that the 20% test is not met, and it is not corrected in 45 days, then this determination ceases to apply from the first day of the following Quarter.
3. That the Harness Macro Currency Strategy continuously trades in foreign exchange and foreign exchange related derivative financial instruments. If an event occurs and the requirement is not met for a continuous period of 45 days, then this determination ceases to apply from the first day of the following Quarter.

Interpretation

In this determination unless the context otherwise requires:

- "Harness Fund" means the Harness Macro Currency Fund, which is a sub-fund of the issuer CitiFirst Investments plc;

- "CitiFirst Investments plc" means the legal entity used for holding the investments, which is incorporated as a company under the laws of Ireland;
- "Fair dividend rate method" means the fair dividend method under section YA 1 of the Income Tax Act 2007;
- "Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;
- "Foreign Investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;
- "Quarter" has the meaning contained in section YA 1 of the Income Tax Act 2007;
- "The NZFM Funds" means a trust managed by New Zealand Funds Management Limited.

Determination

This determination applies to an attributing interest in a FIF, being a direct income interest in the Harness Fund. This is a type of attributing interest for which the NZFM Funds may use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2015 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for the 2015 income year for an investor in the Harness Fund unless that investor chooses for this determination to apply for that year.

Dated at Christchurch on the 15th day of December 2014.

John Trezise
Investigations Manager, Investigations and Advice

SPECIAL DETERMINATION S30: SPREADING METHOD TO BE USED BY A COMPANY AND GROWERS FOR A SHARE INCENTIVE SCHEME AND VALUATION OF SHARES ISSUED UNDER THE SCHEME

This determination may be cited as Special Determination S30: "Spreading method to be used by a company and growers for a share incentive scheme and valuation of shares issued under the scheme".

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

1. This determination relates to a share incentive scheme (the Scheme) established by a company (Company A).
2. Under the Scheme, eligible growers commit to exclusively supplying all of their produce through a company (Company B) for a three-year period and to appointing Company B as their agent for that period under the terms and conditions of a yearly agency/supply agreement between Company B and growers. Under the agency/supply agreement, the grower authorises Company B to act as the grower's agent in negotiating service arrangements (eg, packaging and cool storage) with Company A (via an annual Services Agreement (SA)) and to supply the grower's produce to marketers. Under the SA, Company A agrees to supply post-harvest services to the grower for which it is paid fees.
3. In exchange for exclusively committing to supply produce through the Scheme, at the end of each growing season the grower will become entitled to the issue of shares in Company A for no cash consideration. The number of shares issued is based on the number of produce trays supplied by the grower during the supply season.
4. The Arrangement is the subject of private ruling BR Prv 14/75 issued on 26 November 2014, and is fully described in that ruling.
5. The Scheme is a financial arrangement under s EW 3 and an agreement for the sale and purchase of property or services as defined in s YA 1 of the Income Tax Act 2007. The SA/supply agreement is a short-term agreement for sale and purchase as defined in s YA 1. The Scheme and the SA/supply agreement are, together, a wider financial arrangement.
6. Company A has adopted International Financial Reporting Standards (IFRSs) for the purpose of preparing its accounts.

2. Reference

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

3. Scope of determination

1. This determination applies to a share incentive scheme (the Scheme) for growers, established by a company (Company A).
2. Under the Scheme, eligible growers commit to exclusively supplying all of their produce for a three year period and to appointing Company B as their agent for that period under the terms and conditions of a yearly agency/supply agreement between Company B and growers. Under the agency/supply agreement, the grower authorises Company B to act as the grower's agent in negotiating service arrangements (eg, packaging and cool storage) with Company A (via an annual Services Agreement (SA)) and to supply the grower's produce to marketers. Under the SA, Company A agrees to supply post-harvest services to the grower for which it is paid fees.
3. In exchange for exclusively committing to supply produce through the Scheme, at the end of each growing season the grower will become entitled to the issue of shares in Company A for no cash consideration. The number of shares issued is based on the number of produce trays supplied by the grower during the supply season. Growers are allocated the greater of 10 cents worth of new shares for each tray supplied or a minimum holding. The issue price for the shares is based on the volume weighted average sale price of shares on the NZX Main Board over the 20 Business Days prior to 31 August of the applicable year.
4. This determination applies to determine the spreading method to be used by Company A in respect of the Arrangement.
5. This determination also applies when:
   - Post-harvest services are provided by Company A to growers to determine the value of the services provided by Company A for the purposes of the financial arrangements rules;
   - Shares are issued by Company A to growers to determine the value of the shares issued by Company A for the purposes of the financial arrangements rules.

6. This determination is made subject to the following conditions:
   i) Company A will continue to recognise income derived from the SA/supply agreement and deduct expenditure incurred in relation to the SA/supply agreement under the Income Tax Act (primarily Parts C and D) (other than amounts dealt with under this determination).

4. Principle

1. The Scheme is a financial arrangement under s EW 3 and an agreement for the sale and purchase of property or services as defined in s YA 1. The Scheme and the SA/supply agreement are, together, a financial arrangement as defined in s EW 3.
2. The SA/supply agreement is an excepted financial arrangement (a short-term agreement for sale and purchase) under s EW 5(22). Under s EW 6(3), all amounts solely attributable to that excepted financial arrangement are taken into account under the financial arrangements rules.
3. Under s EW 15I, because the financial arrangement includes in part an excepted financial arrangement, s EW 15C(1) does not apply and one of the methods in s EW 15I(2) must be used to allocate an amount of income or expenditure to an income year.
4. One of the methods available under s EW 15I(2)(c) is a determination made by the Commissioner.
5. For the purposes of determining the consideration paid or payable under the financial arrangements rules, the value of the post-harvest services provided by Company A and the shares issued by Company A to growers must be established under s EW 32.
6. Under s EW 32(6), the Commissioner is required to determine the value of the services and shares. Both Company A and growers are required to use this amount.
7. The only amounts payable under the Arrangement that are required to be spread under the financial arrangements rules are the amounts allocated to the issue of the Company A shares to growers in each year of the Scheme.

5. Interpretation

In this determination (and the Explanation), unless the context otherwise requires:

- Words and expressions used (which have not been defined elsewhere within the determination) have the same meaning as in s YA 1 of the Income Tax Act 2007.
- "the Scheme" means Company A's share incentive scheme.
- "SA" means the Services Agreement between Company A and Company B.
- "SA/supply agreement" means the SA between Company A and Company B and the agency/supply agreement between Company B and growers.
- "IFRS financial reporting standard" means a New Zealand Equivalent International Financial Reporting Standard, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place.

6. Method

1. The amounts to be spread in relation to the shares issued by Company A must be allocated to an income year by applying NZ IAS 32 (the method used by Company A for IFRS financial reporting purposes). NZ IAS 32 establishes principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. For IFRS financial reporting purposes, Company A will recognise the shares when they are issued by discounting Revenue in the P&L for 10 cents per tray for all trays packed in the season for eligible growers and increasing Equity on the Balance Sheet. In the event that a grower is allocated a greater number of shares than under the 10 cents per tray method (to reach a minimum shareholding) the accounts will reflect the actual value of the shares issued and the discount to Revenue.
2. For the purposes of s EW 32(6), the value of the shares issued by Company A is equal to the issue price determined by reference to the volume weighted average sale price of shares on the NZX Main Board over the 20 Business Days prior to 31 August of the applicable supply season (subject to adjustment by the Board).
3. For the purposes of s EW 32(6), the value of the post-harvest services provided by Company A is equal to the price paid for the services by growers.

7. Example

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

Company A provides a share incentive scheme to growers who commit to using its produce post-harvest services for a three year period. Growers are allocated the greater of 10 cents worth of new shares for each tray supplied or a minimum holding. Company A provides services to growers costing $50 in return for service fees of $100 in a year. At the end of the year, Company A issues shares to growers worth $10, based on the volume weighted average sale price of shares on the NZX Main Board over the 20 Business Days prior to 31 August of the applicable year.

Company A will use NZ IAS 32: Financial instruments to allocate income and expenditure relating to the issue of the shares. This means that, when the shares are issued, Company A will recognise a discount to Revenue in the P&L for 10 cents per tray for all trays packed in the season for eligible growers and an increase to Equity will be recognised in the Balance Sheet.

If a grower is allocated a minimum holding instead of 10 cents worth of new shares per tray, the accounts will reflect the actual value of the shares issued and the corresponding discount to Revenue in the P&L.

The value of the shares for the purposes of s EW 32 is $10.

The value of the services for the purposes of s EW 32 is $100.

SPECIAL DETERMINATION S31: APPLICATION OF FINANCIAL ARRANGEMENTS RULES TO INVESTORS IN THE LIFETIME INCOME FUND

This determination may be cited as Special Determination S31: "Application of financial arrangements rules to Investors in the Lifetime Income Fund".

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

1. The Lifetime Income Fund (the Fund) is a unit trust in which members of the general public up to the age of 85 can invest their retirement savings (or a proportion of them) built up through savings in a KiwiSaver scheme or otherwise. The Fund will manage the investment in a similar manner to a KiwiSaver scheme through the Balanced Portfolio which will invest in low cost share and fixed interest index funds. The Fund will also manage distributions to provide income (the Lifetime Withdrawal Benefit) for the Investor over their retirement lifetime (from age 65 onwards).
2. The Lifetime Income Fund will achieve this by purchasing a life insurance policy or policies in the name of the Trustee and for the benefit of Investors (the Lifetime Withdrawal Benefit), along with offering an investment in a managed fund. The Cash Portfolio will be invested in cash and liquid fixed income investments. Premiums will be paid by the Fund manager to Lifetime Income Limited (LIL) annually by redeeming units held for an Investor in the Cash Portfolio. The amount of the premiums will be actuarially calculated based on factors specific to the Investor.
3. The Lifetime Withdrawal Benefit of the Investor is set at a percentage of their Protected Income Base, being the original capital sum invested in the Fund net of any applicable fees and including any increase in value during the Investor's Deferral Period (the period up to the time the Investor begins receiving payments of the Lifetime Withdrawal Benefit). The Investor may elect to commence receiving their Lifetime Withdrawal Benefit at any time from age 65 until age 85. The payments will be made:
   - first, out of the capital invested by an Investor in the Lifetime Income Fund and the Investor's proportion of the Fund's post-tax earnings accumulated as a result of investing the original capital sum and;
   - second, from a life insurance policy or policies purchased by the Fund for the benefit of each individual Investor.
4. The Arrangement is the subject of product ruling BR Prd 14/10 and private ruling BR Prv 14/82 issued on 24 December 2014, and is fully described in those rulings.
5. The Arrangement is a financial arrangement under s EW 3 of the Income Tax Act 2007. The units in the Fund are excepted financial arrangements under s EW 5(13) and the annuity provided by LIL is an excepted financial arrangement under s EW 5(2), forming part of the financial arrangement.
6. Under s EW 6(2), an amount that is solely attributable to an excepted financial arrangement described in any of ss EW 5(2) to (16) is not an amount taken into account under the financial arrangements rules. This determination specifies the amounts that are solely attributable to the units and the annuity.

2. Reference

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

3. Scope of determination

1. This determination applies to an investment in the Lifetime Income Fund (the Fund) and payments received by Investors from the Fund and Lifetime Income Limited (LIL). The Fund is a unit trust that will elect to be a portfolio investment entity (PIE) under s HM 71.
2. The Fund is a product in which members of the general public up to the age of 85 can invest their retirement savings (or a portion of them) built up through savings in a KiwiSaver scheme or otherwise. The Fund will manage the investment in a similar manner to a KiwiSaver scheme through the Balanced Portfolio, which will invest in low cost share and fixed interest index funds. The Fund will also manage distributions to provide income (the Lifetime Withdrawal Benefit) for the Investor over their retirement lifetime (from age 65 onwards).
3. The Fund will achieve this by purchasing a life insurance policy or policies in the name of the Trustee and for the benefit of Investors (the Lifetime Withdrawal Benefit), along with offering an investment in a managed fund. The Cash Portfolio will be invested in cash and liquid fixed income investments. Premiums will be paid by the Fund manager to LIL annually by redeeming units held for an Investor in the Cash Portfolio. The amount of the premiums will be actuarially calculated based on factors specific to the Investor.

4. The Lifetime Withdrawal Benefit of the Investor is set at a percentage of their Protected Income Base, being the original capital sum invested in the Fund net of any applicable fees and including any increase in value during the Investor's Deferral Period (the period up to the time the Investor begins receiving payments of the Lifetime Withdrawal Benefit). The Investor may elect to commence receiving their Lifetime Withdrawal Benefit at any time from age 65 until age 85. The payments will be made:
   - first, out of the capital invested by an Investor in the Fund and the Investor's proportion of the Fund's post-tax earnings accumulated as a result of investing the original capital sum and;
   - second, from a life insurance policy or policies purchased by the Fund for the benefit of each individual Investor.
5. This determination is made subject to the condition that private ruling BR Prv 14/82 continues to apply (under s 91EB of the Tax Administration Act 1994).

4. Principle

1. The Arrangement is a financial arrangement under s EW 3. The units in the Fund are excepted financial arrangements under s EW 5(13) and the annuity provided by LIL is an excepted financial arrangement under s EW 5(2), forming part of the financial arrangement.
2. Under s EW 6(2), an amount that is solely attributable to an excepted financial arrangement described in any of ss EW 5(2) to (16) is not an amount taken into account under the financial arrangements rules.
3. This determination specifies the amounts received by an Investor that are solely attributable to the units and the annuity.
4. Due to the amounts set out in specified in this determination being solely attributable to excepted financial arrangements, no income or expenditure will arise for an Investor in the Fund under the financial arrangements rules.

5. Interpretation

This determination has no specialised terms that need to be defined further.

6. Method

1. The amounts that are solely attributable to the units in the Fund are:
   - any payments received by an Investor from the Fund under the Lifetime Withdrawal Benefit; and
   - any gains or losses made by an Investor who buys or sells units in the Fund.
2. The amounts that are solely attributable to the annuity paid by LIL to an Investor are any annuity payments received by the Investor under the Lifetime Withdrawal Benefit.

7. Examples

These examples illustrate the application of the method set out in this determination.

Example A

An Investor invests $100,000 in the Fund at age 65 and in return acquires units in the Fund. The investment grows in value after five years to $112,900 net of fees and taxes. During that period, the Fund pays premiums on behalf of the Investor to LIL under a life insurance policy.

The Investor opts to receive their Lifetime Withdrawal Benefit from the Fund from age 70, which means the Benefit is set at 6% of their Protected Income Base of $112,900. This means they receive $6,774 per annum in fortnightly payments.

At age 97, the Investor's capital in the Fund is exhausted and the Investor continues to receive a minimum income of $6,774 per annum in fortnightly payments under the annuity.

The payments of $6,774 per annum paid by the Fund are solely attributable to the units in the Fund. The payments of $6,774 per annum made by LIL to an Investor under the life insurance policy are solely attributable to the annuity.

Example B

This example follows Example A but, at age 75, the Investor withdraws $20,000 as an Unplanned Withdrawal, reducing the Lifetime Withdrawal Benefit payments to 5.20% per annum. This means they receive $5,871 per annum in fortnightly payments.

The payments made by the Fund are solely attributable to the units in the Fund. The payments made by LIL to an Investor under the life insurance policy are solely attributable to the annuity.

This Determination is signed by me on the 24th day of December 2014.

Howard Davis
Director (Taxpayer Rulings)

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 14/13: GST – LOTTERIES, RAFFLES, SWEEPSTAKES AND PRIZE COMPETITIONS

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

This Question We've Been Asked (QWBA) is about ss 2(1) "prize competition", 3A, 5(10), 5(11), 9(2)(e), 10(14), 10(15), 20(3), 20(3C) and 20(3K).

Question

1. What are the GST implications of conducting a lottery, raffle, sweepstake or prize competition?

Answer

2. A person who is GST registered (or is liable to be GST registered) needs to account for GST on any lottery, raffle, sweepstake or prize competition they conduct. GST must be calculated on the amount paid by the participants in the lottery, raffle, sweepstake or prize competition, less the amount of all prizes paid or payable in money.

3. An unincorporated body of persons or an association of people formed for non-commercial purposes can be the conductor of a lottery, raffle, sweepstake or prize competition. This could include an unincorporated body or association conducting a lottery, raffle, sweepstake or prize competition on behalf of a school, kindergarten or other community group. For lotteries, raffles and sweepstakes, GST needs to be accounted for in the GST period that the first drawing or determination of the result of the lottery, raffle or sweepstake commences. (Although unlikely to apply in many cases, there is an exception to this special rule where the lottery, raffle or sweepstake is an instant game played by means of a gaming machine. In this limited situation GST is accounted for under the normal GST time of supply rules.) For prize competitions, GST needs to be accounted for in the GST period that the first drawing or determination of the prize competition commences.

4. Claiming input tax reduces the total amount of GST payable. Input tax can be claimed for any GST component of the cost of goods or services that are purchased and used for the making of a taxable supply of gambling or prize competition services. Conducting a lottery, raffle, sweepstake or prize competition is a taxable supply of gambling or prize competition services. If the goods or services are only partly used for making taxable supplies, then an apportionment may be necessary. A special input tax rule applies to non-profit bodies and ensures that a non-profit body can claim input tax on all acquired goods and services that relate to non-exempt supplies. "Non-profit body" is defined in s 2 and a charity will often be a non-profit body for GST purposes.

5. This item covers similar content to BR Pub 07/11 "GST – Lottery operators and promoters" *Tax Information Bulletin* Vol 20, No 1 (February 2008): 6, which expired on 21 December 2012. This item replaces "Cash prizes in sporting competitions – GST implications for organising club" *Tax Information Bulletin* Vol 13, No 5 (May 2001): 52.

Explanation

Background

6. The subject matter covered in this QWBA was previously covered in BR Pub 07/11 "GST – Lottery operators and promoters", which expired on 21 December 2012, and the QWBA "Cash prizes in sporting competitions – GST implications for organising club", issued May 2001. Legislative changes relating to prize competitions have resulted in the 2001 QWBA no longer being correct. These legislative changes apply from 17 July 2013. Under the new legislative provisions, cash prize amounts are now allowed to be deducted when calculating the consideration for the supply of prize competition services. Consequently, the amount of GST payable is reduced.

7. This item does not apply to racing betting or sports betting that are covered under specific GST rules in ss 5(8) and 10(12).

What is the nature of the supply?

8. If a person conducts a lottery, raffle, sweepstake or prize competition, they are making a supply of services, which may have GST implications.

9. Under s 5(10), a supply of gambling or prize competition services occurs where a person pays money to participate. Section 5(10) states that:

> **5 Meaning of term supply**
>
> ...
>
> (10) For the purposes of this Act, an amount of money paid by a person to participate in gambling (including a New Zealand lottery) or in a prize competition is treated as a payment for a supply of services by the following:
>
> (a) for gambling, by the person, society, licensed promoter, or organiser who under the Gambling Act 2003 conducts the gambling:
>
> (b) for a prize competition, by the person who conducts the prize competition.

10. Note that s 14(1)(b) exempts a supply of donated goods and services by a non-profit body from GST. It states:

> **14 Exempt supplies**
>
> (1) The following supplies of goods and services shall be exempt from tax:
>
> ...
>
> (b) the supply by any non-profit body of any donated goods and services:

11. However, as mentioned above, conducting a lottery, raffle or sweepstake is a supply of gambling services and conducting a prize competition is a supply of prize competition services. It is the gambling or prize competition services that the participants are paying for, not the ultimate prizes. Therefore, even where donated goods or services are given as prizes in a lottery, raffle, sweepstake or prize competition conducted by a non-profit body, the nature of the relevant supply is still the supply of gambling or prize competition services under s 5(10).

12. Section 5(11) provides the following definitions for the purposes of s 5(10):

> (11) For the purposes of subsection (10)—
>
> (a) the terms **gambling, New Zealand lottery, licensed promoter,** and **society** have the meanings set out in section 4(1) of the Gambling Act 2003:
>
> (b) the term **organiser** means the New Zealand Lotteries Commission continued by section 236 of the Gambling Act 2003.

13. Section 2(1) provides the following definition of "prize competition" for the GSTA:

> **prize competition** means a scheme or competition—
>
> (a) for which direct or indirect consideration is paid to a person for conducting the scheme or competition; and
>
> (b) that distributes prizes of money or in which participants seek to win money; and
>
> (c) for which the result is determined—
>
> (i) by the performance of the participant of an activity of a kind that may be performed more readily by a participant possessing or exercising some knowledge or skill; or
>
> (ii) partly by chance and partly by the performance of an activity as described in subparagraph (i), whether or not it may also be performed successfully by chance:

14. As a result, a supply of gambling or prize competition services occurs if a person pays an amount in money:

- to participate in "gambling", as defined in s 4(1) of the Gambling Act 2003 (including a "New Zealand lottery" run by the New Zealand Lotteries Commission), or
- to participate in a "prize competition", as defined in s 2(1).

What is "gambling" under the Gambling Act 2003?

15. "Gambling" is defined in s 4(1) of the Gambling Act 2003 as follows:

> **4 Interpretation**
>
> (1) In this Act, unless the context otherwise requires,—
>
> ...
>
> **gambling—**
>
> (a) means paying or staking consideration, directly or indirectly, on the outcome of something seeking to win money when the outcome depends wholly or partly on chance; and
>
> (b) includes a sales promotion scheme; and
>
> (c) includes bookmaking; and
>
> (d) includes betting, paying, or staking consideration on the outcome of a sporting event; but
>
> (e) does not include an act, behaviour, or transaction that is declared not to be gambling by regulations made under section 368.

No regulations under s 368 of the Gambling Act 2003 are relevant to this QWBA.

16. The above definition shows that in order for something to be "gambling" in terms of s 4(1) of the Gambling Act 2003, there is a requirement of seeking to win money. For the Gambling Act, "money" is defined as including "money's worth, whether or not convertible into money". Therefore money's worth, in this context, is anything that is of some value, even if

it cannot be converted into money. This means that things like vouchers for goods or services and other non-cash prizes (including any donated prizes) are treated as "money" under the Gambling Act. It also means that lotteries and raffles that offer non-cash prizes are within the definition of "gambling".

Is participating in a "lottery", "raffle" or "sweepstake" within the definition of "gambling"?

17. The definition of "gambling" in s 4(1) of the Gambling Act 2003 does not expressly include a lottery, raffle or sweepstake. However, the Commissioner considers that lotteries, raffles and sweepstakes fall within the definition of "gambling" and are therefore subject to s 5(10)(a) of the GSTA.

18. Section 4(1) of the Gambling Act 2003 defines the term "lottery" as specifically including raffles and sweepstakes, stating that:

> **4 Interpretation**
>
> (1) In this Act, unless the context otherwise requires,—
>
> ...
>
> **lottery—**
>
> (a) means a scheme or device involving multiple participants for which—
>
> (i) a person pays consideration to participate, directly or indirectly; and
>
> (ii) prizes of money are distributed according to a draw that takes place after all participants have entered; and
>
> (b) includes lotto, raffles, and sweepstakes

19. The terms "raffle" and "sweepstake" are not defined in the Gambling Act 2003. The ordinary meanings of "raffle" and "sweepstake" in the *Concise Oxford English Dictionary* (12th edition, Oxford University Press, New York, 2011) are (relevantly):

> **raffle**[1] **• n.** a lottery with goods as prizes.
>
> ...
>
> **sweepstake** (also **sweepstakes) • n.** a form of gambling, especially on sporting events, in which all the stakes are divided among the winners.

20. Lotteries, raffles and sweepstakes all involve paying or staking consideration on the outcome of something seeking to win money (including money's worth) when the outcome depends wholly or partly on chance. This means that lotteries, raffles and sweepstakes fall within the definition of "gambling" in s 4(1)(a) of the Gambling Act 2003. Given that sweepstakes are also particularly associated with staking consideration on the outcome of sporting events, sweepstakes may also fall within para (d) of the definition of "gambling" in s 4(1) of the Gambling Act 2003.

21. As a result, a supply will be deemed to occur under s 5(10)(a) of the GSTA if a person pays money to participate in a lottery, raffle or sweepstake. If the supplier of such gambling services is a GST registered person (which includes a person who is liable to be GST registered), they will need to account for GST for the supply of those services.

What is a prize competition?

22. With application from 17 July 2013, s 10 of the GSTA was amended so that a person conducting a prize competition is able to deduct cash prizes from the total proceeds received for a prize competition when determining the consideration made for that supply. Before this amendment, cash prizes could only be deducted in relation to gambling and not prize competitions.

23. Consequently, ss 5 and 9 of the GSTA were amended to include references to prize competitions and a definition of "prize competition" for the GSTA was also included in s 2(1) (see [13] above).

24. For GST purposes, "prize competition" includes competitions where the participant pays to enter and is competing for a cash prize and where the result is determined either solely by the performance of participants of a particular kind of activity or partly by chance and partly by the performance of participants of a particular kind of activity. This means that participants may possess or exercise some knowledge or skill that relates to the activity, for example amateur sporting competitions. The Gambling Act 2003 also contains a narrower definition of "prize competition" in s 4(1) of the Gambling Act 2003. However, this definition is not relevant for determining the GST consequences of running a prize competition.

25. A supply is deemed to occur under s 5(10)(b) of the GSTA if a person pays money to participate in a prize competition. If the supplier of such services is a GST registered person (which includes a person who is liable to be GST registered), they will need to account for GST on that supply.

Who is the supplier?

26. It is necessary to determine who is making the supply of gambling or prize competition services. Whether there are GST obligations will depend on whether the supplier is GST registered (or required to be). For information about who is required to register for GST see currently: **http://www.ird.govt.nz/gst/gst-registering/register-who/**. Generally, you must register for GST if your turnover (sales from taxable activities) was over $60,000 for the last 12 months or is expected to go over $60,000 for the next 12 months.

27. Section 5(10)(a) states that the supplier of gambling services is "the person, society, licensed promoter, or organiser who under the Gambling Act 2003 conducts the gambling". Section 5(10)(b) states that the supplier of prize competition services is "the person who conducts the prize competition".

28. "Person" is defined in s 2(1) of the GSTA as including "a company, an unincorporated body of persons, a public authority, and a local authority". Section 5(11) states that "society" has the meaning set out in s 4(1) of the Gambling Act 2003, which is "an association of persons established and conducted entirely for purposes other than commercial purposes".

29. Therefore, community organisations, schools, kindergartens, etc, which may operate as unincorporated bodies or non-profit associations, can be suppliers of gambling or prize competition services for GST purposes. In the case of state schools, often it will be the Board of Trustees or, if one exists, the Parent Teacher Association (being a separate entity from the Board of Trustees) that is running the raffle, lottery, sweepstake or prize competition, so they are the supplier of the gambling or prize competition services for GST purposes. If such an organisation is a GST registered person (which includes a person who is liable to be registered), they need to account for GST on any lotteries, raffles, sweepstakes or prize competitions they conduct.

30. There may be other people involved in the running of a lottery, raffle or sweepstake who are "conducting gambling" under the broad definition of that term in the Gambling Act 2003 (eg, anyone selling tickets, distributing prizes or otherwise involved in organising, supervising or running the lottery, raffle or sweepstake). However, for GST purposes the supplier is the person or organisation conducting the gambling that people are paying to participate in. This is the person or organisation ultimately running the lottery, raffle or sweepstake (ie, the person or organisation on whose behalf the tickets are being sold).

What is the time of supply?

31. The time of supply of the gambling or prize competition services must be established because this determines when GST needs to be accounted for.

32. Section 9(2)(e) deems the time of supply for gambling services (lotteries, raffles or sweepstakes) generally to be the date on which the first drawing or determination of the result commences and the time of supply for prize competition services to be the date on which the first drawing or determination of the prize competition commences. Section 9(2)(e) states that:

> **9 Time of supply**
>
> ...
>
> (2) Notwithstanding anything in subsection (1) of this section, a supply of goods and services shall be deemed to take place—
>
> ...
>
> (e) if the supply is made under section 5(10),—
>
> (i) for an amount of money paid by a person to participate in gambling (including a New Zealand lottery), on the date on which the first drawing or determination of a result commences, but this subparagraph does not apply to an instant game that is a **New Zealand lottery** or **gambling** played by means of a gaming machine as defined in section 4(1) of the Gambling Act 2003:
>
> (ii) for an amount of money paid by a person to participate in a prize competition on the date on which the first drawing or determination of the prize competition commences:

33. Although unlikely to occur very often in the context of lotteries, raffles or sweepstakes, there is an exception to the special time of supply rule above. The exception is where the lottery, raffle or sweepstake is an instant game played by means of a gaming machine. In this limited situation GST is accounted for under the normal GST time of supply rules. The terms "gaming machine" and "instant game" are defined in s 4(1) of the Gambling Act 2003. Generally a gaming machine is any machine or device that is adapted or designed, and constructed for use in gambling. An example of a gaming machine is a pokie machine. An instant game means gambling when a winning ticket or the money or other reward that the winning ticket bears is determined before, or simultaneously with, the sale of tickets, randomly or wholly by chance. Examples of an instant game are a scratch and win game or mystery envelopes.

What is the consideration for the supply?

34. GST needs to be returned on the amount of consideration for a supply. The GSTA specifies what the amount of consideration for a supply of gambling or prize competition services will be.

35. Under ss 10(14)(a) and (b), the consideration for the supply of gambling or prize competition services is the total of all amounts received from the participants in the gambling or prize competition, less any prizes paid and payable in money. Section 10(14) states as follows:

> **10 Value of supply of goods and services**
>
> (1) For the purposes of this Act the following provisions of this section shall apply for

determining the value of any supply of goods and services.

...

(14) If a supply of services is treated as having been made under section 5(10), the consideration for the supply is calculated using the formula—

amounts received – prizes

where—

(a) **amounts received** is the total of all amounts in money received in relation to the supply—

(i) for gambling, by the person, society, licensed promoter, or organiser who under the Gambling Act 2003 conducts the gambling:

(ii) for a prize competition, by the person who conducts the prize competition:

(b) **prizes** is the total amount of all prizes paid and payable in money in relation to the supply.

36. If the prizes in a lottery, raffle, sweepstake or prize competition are non-cash prizes, then the consideration for the supply is simply the amounts received from the participants to participate in the lottery, raffle, sweepstake or prize competition. In other words, the consideration for the supply is only reduced for cash prizes.

What input tax can a supplier claim?

37. Input tax deductions reduce the total amount of GST payable. Input tax can be claimed for any GST component of the cost of goods or services that are acquired and used for the making of a taxable supply: ss 3A and 20(3). As seen, conducting a lottery, raffle, sweepstake or prize competition is a taxable supply of gambling or prize competition services.

38. If non-cash prizes in a lottery, raffle, sweepstake or prize competition are purchased by the supplier, then an input tax deduction may be available for any GST component of the cost of those prizes. However, if non-cash prizes in a lottery, raffle, sweepstake or prize competition are donated goods or services, then no input tax deduction is available to the supplier as no GST component was paid for the prize.

39. If the goods or services acquired are only partly used for making taxable supplies, then an apportionment may be necessary: s 20(3C).

40. A special input tax rule applies to non-profit bodies allowing a non-profit body to claim input tax on goods or services acquired that are used for other than making taxable supplies (see s 20(3K)). This rule does not apply to the extent that the goods or services are used for making exempt supplies.

What are the practical implications for a person running a raffle, lottery, sweepstake or prize competition?

41. Running a raffle, lottery, sweepstake or prize competition has a number of GST implications. There may be a requirement to register for GST if the value of supplies (including the gambling or prize competition supplies) made by the person running the raffle, lottery, sweepstake or prize competition exceeds the GST registration threshold (currently $60,000): see s 51.

42. Where the organisation running the raffle, lottery, sweepstake or prize competition is GST registered GST will need to be paid on the value of the total amount of tickets sold or fees paid, less any cash prizes paid or payable. This may mean that an organisation's accounting system requires a separate account for lottery and raffle proceeds, to ensure that these funds are treated as being subject to GST, as opposed to other fundraising funds which may be treated as GST-exempt. As discussed above, input tax credits may be claimed on costs associated with running a raffle, lottery, sweepstake or prize competition.

43. There may potentially be tax invoicing requirements (see s 24). However, if the consideration for the supply does not exceed $50, a tax invoice is not required to be provided (s 24(5)).

44. This QWBA does not address the requirements under the Gambling Act 2003 that need to be satisfied. For information on the relevant rules for running a gambling activity, and whether a licence is needed, refer to: **http://www.dia.govt.nz/gambling**.

Examples

45. The following examples explain the application of the GST provisions.

Example 1: Fundraising raffle

46. The Sunnytown pre-school is a community-based, not-for-profit organisation and is GST registered.

47. As part of its annual fundraising the pre-school runs a raffle, selling tickets for $2 each. The raffle prizes include a family ferry voucher (donated by a ferry company), $100 cash, a massage voucher (donated by the local day-spa) and a basket of grocery items (purchased by the pre-school). The raffle is drawn at the end of term 4.

48. The raffle is a "lottery" and, therefore, "gambling" for the purposes of the GSTA. The pre-school, in conducting the raffle, is a supplier of gambling

services for GST purposes. As the pre-school is GST registered, it must account for GST on this fundraiser.

49. The time of supply is the date at the end of term 4 on which the raffle is drawn. GST on the raffle must be accounted for in the GST return for the GST period in which that date falls.

50. The consideration for the raffle is the total amount received from ticket sales, minus the $100 paid as a cash prize. Input tax can be claimed for the basket of grocery items purchased by the pre-school. No input tax can be claimed for the donated prizes (ie, the ferry voucher and the massage voucher).

Example 2: Sweepstake

51. The Canterville Working Men's Club is GST registered. Every year it runs a sweepstake for the Melbourne Cup. Participants pay to enter the sweepstake and are randomly allocated a horse. The total amount paid by participants is divided among the participants who were allocated the horses that placed 1st, 2nd and 3rd.

52. The sweepstake is a "lottery" and, therefore, "gambling" for the purposes of the GSTA. The Canterville Working Men's Club, in conducting the sweepstake, is a supplier of gambling services for GST purposes. As the club is GST registered, it must account for GST on the sweepstake.

53. The time of supply is the date of the Melbourne Cup, as the determination of the result commences on that day. GST on the sweepstake must be accounted for in the GST period in which that date falls.

54. The consideration for the supply is the total amount received from participants, less the total amount paid out in prizes in money. As all of the money paid by participants is paid out in prizes, there is no consideration for the supply of gambling services by the Canterville Working Men's Club for the sweepstake. This means that the club is not required to account for any GST on the sweepstake.

Example 3: Skill only prize competition

55. The Somes Bowling Club is a GST-registered amateur sports club. People pay a membership fee to be members of the club and use the facilities. The club organises a Christmas Gala bowls competition on 14 December 2013. Members pay $10 and non-members $20 to compete. The winners in the different categories are awarded cash prizes totalling $150 on the day of the competition.

56. The Christmas Gala bowls competition is a prize competition. People pay consideration to participate. The Somes Bowling Club, in conducting the competition, is a supplier of prize competition services for GST purposes. As the club is GST registered, it must account for GST on the competition.

57. The time of supply is 14 December 2013, the date on which the prize competition is determined. GST on the prize competition must be accounted for in the GST period in which that date falls.

58. The prize competition was conducted after 17 July 2013—being the date when the new legislative provisions relating to prize competitions took effect. As such, the club is allowed to deduct the $150 of cash prizes from the total fees received for the competition when calculating the consideration for the prize competition.

References

Related rulings/statements
BR Pub 07/11 "GST – lottery operators and promoters", *Tax Information Bulletin* Vol 20, No 1 (February 2008): 6
"Cash prizes in sporting competitions – GST implications for organising club", *Tax Information Bulletin* Vol 13, No 5 (May 2001): 52
Subject references
GST; lottery; raffle; sweepstake; prize competitions
Legislative references
Goods and Services Tax Act 1985 – ss 2(1), 3A, 5(10), 5(11), 9(2)(e), 10(14), 10(15), 20(3), 20(3C) and 20(3K)
Gambling Act 2003 – s 4(1)
Other references
Concise Oxford English Dictionary (12th edition, Oxford University Press, New York, 2011)

QB 14/14: GST – LATE RETURN CHARGES (INCLUDING LIBRARY FINES AND PARKING OVERSTAY CHARGES)

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

This Question We've Been Asked (QWBA) is about ss 2, 8 and 10.

During a review of the *Public Information Bulletin* and *Tax Information Bulletin* series published before 1996, the answer to Question 8 (in a series of GST questions and answers) in *Public Information Bulletin* No 148 (May 1986): 3 was identified as an item that should be updated. The review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013): 37.

This QWBA updates and replaces the part of the *Public Information Bulletin* item that concerns library fines and vehicle parking fines (also known as parking overstay charges). For ease of reference, this QWBA refers to these fines collectively as "late return charges". The analysis in this item also applies more broadly to all charges imposed for the late return of a borrowed item (ie, not just to library fines and vehicle parking fines).

Question

1. Is a late return charge subject to GST?

Answer

2. A late return charge will be subject to GST if it is consideration for a taxable supply. Whether the charge is consideration for a taxable supply will depend on whether a sufficient nexus or reciprocity exists between the charge and the supply. This will be determined from the legal arrangements entered into.
3. In most cases, a late return charge will be subject to GST. This is because the legal arrangements between the parties will characterise the charge as additional consideration for the supply of the borrowed item.
4. However, in some cases, the legal arrangements between the parties may characterise the late return charge as a payment of damages or a penalty for a breach of the legal arrangements. In these cases, the charge will not be subject to GST because it will not be consideration for a taxable supply.

Explanation

Background

5. *Public Information Bulletin* No 148 (May 1986): 3 contained a series of questions and answers on GST. Question 8 asked, "Are vehicle parking fines and library fines etc. subject to GST?". The answer was:

   > Yes – they are consideration for the provision of goods and services. However, Court fines are not subject to GST because they are not paid as consideration for the supply of goods and services. Rather they are penalties imposed by Statute as punishment for criminal activities.

6. Late return charges are charges imposed for the late return of a borrowed item such as a library book or a DVD. These charges are sometimes referred to as "overdue fines". Car-park operators impose similar charges on drivers who overstay in a parking space. These charges all share similar features. For ease of reference, we refer to them collectively as "late return charges".
7. Late return charges are different from late payment charges. Late payment charges are amounts businesses charge for the late payment of an account. Under s 5(25) and (26), a late payment charge will be subject to GST if the underlying supply to which that payment relates is subject to GST.

GST treatment of late return charges

8. The Commissioner considers the law in this area to be well settled. The late return charge is either consideration for a supply or not. The Commissioner has set out the principles to be applied in "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin*, Vol 14, No 10 (October 2002): 21 and "GST – Hire Firm Security Bonds" *Tax Information Bulletin* Vol 26, No 7 (August 2014): 131. This QWBA simply applies these principles to different fact scenarios.

Taxable supply

9. Section 8(1) imposes GST on the supply of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person. GST is charged on the value of that supply. The value of a supply is the "consideration" paid for the supply (ss 2(1) "consideration" and 10).
10. Therefore, the first step is to identify a supply, if any, for which the late return charge could be consideration. The next step is to determine whether the late return charge is consideration for that supply (see *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093 (CA)).
11. When analysing transactions for GST purposes, the focus is on the legal rights and obligations created by the parties. The economic substance of the transaction is not relevant, and the nomenclature used is not decisive. The important question is whether

a sufficient nexus or reciprocity exists between the supply of the goods or services and the consideration (see *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA), *Chatham Islands Enterprise Trust v CIR* [1999] 2 NZLR 388 (CA); *Gulf Harbour Developments Ltd* (2004) 21 NZTC 18,915 (CA); *Rotorua Regional Airport v CIR* (2010) 24 NZTC 23,979).

Characterisation of late return charges

12. To determine the correct GST treatment of a late return charge it is necessary to examine the legal arrangements entered into between the parties. The late return charge can be characterised in at least two ways: as consideration for a taxable supply or as a payment for a breach of contract.

Consideration for a taxable supply

13. In most cases, a charge imposed under a contract for the late return of a borrowed item will be characterised as consideration for the supply of the borrowed item. A sufficient nexus will exist between the supply of the borrowed item and the charge imposed for its late return.

14. This was the decision reached by the United Kingdom VAT Tribunal in *Leigh t/a Moor Lane Video* (1990) 5 BVC 757 and by the Tax Court of Canada in *Acme Video Inc v R* [1995] GSTC 49. In both cases, the issue was whether a late return charge imposed for the late return of video films was subject to value-added tax (VAT) or GST. In *Leigh*, the contract described the charge as "compensation not exceeding £2.50 for each day or part of a day after it was due". The fine was the same amount as the nightly hire rate. In *Acme*, the contract provided that "the hirer agrees to pay all additional rental or surcharges" that may be due as a result [of the late return]". In both cases, the courts held that the late return charges were liable to VAT/GST as consideration for the supply of the borrowed item.

15. In some cases, the initial supply of the item will be for no consideration (a library book, for example). In the Commissioner's opinion, this will not affect the GST treatment of the late return charge.

Payment for a breach of contract

16. A charge imposed under a contract for breaching the terms of that contract will not be subject to GST. This is because the charge is imposed for the breach rather than as consideration for a supply. In this situation, the charge will not have a sufficient nexus or reciprocity with the supply (see *NZ Refining Co Ltd, and Chatham Islands Enterprise Trust*).

17. Depending on the terms of the contract, a charge for a breach of contract could be described as liquidated damages (an amount agreed to be paid for a breach of contract) or as a penalty (a punishment for a breach of contract). While the distinction between liquidated damages and penalties is important for contract law purposes, it is not significant for GST purposes; neither payment will be subject to GST.

Examples

18. The following examples help to explain how the law applies to particular situations.

19. The GST consequences of each example are a result of the particular facts. Any additions or variations to the facts may give rise to different GST consequences.

Example 1: Consideration for a supply

20. Oscar joins the Central Library. He signs a membership agreement and agrees to be bound by the terms and conditions outlined in the agreement. Oscar takes out a book on quantum physics. The library terms and conditions state that this book can be borrowed for 28 days without charge. After that time, fines will be charged for each day that the book remains overdue. Regarding "overdue fines", the membership agreement notes:

> **Membership agreement – terms and conditions**
>
> All Central Library members agree to be bound by the library fees and charges. Fines accrue each day the book/item is overdue. Details of overdue fines are posted on the Central Library website and must be paid when the item is returned.

21. The Central Library website contains a list of overdue fines. An overdue fine of 60c per day, per item is imposed for all books once the 28-day borrowing period has expired. Oscar returns the book 10 days late and has to pay a $6 fine. The fine is subject to GST because it is consideration for the supply of the book. The fact that it is called a fine does not affect its character as consideration for the supply. It is also not determinative that the initial supply of the library book was a supply for no consideration.

Example 2: Further consideration for a supply

22. Louis joins a DVD library. He signs a membership agreement and agrees to be bound by the terms and conditions of hire. Regarding the late return of DVDs, the agreement states:

> The member agrees:
>
> a. To return the film by the agreed date. If the film is not returned by the agreed date, the

> member shall be required to pay an additional hire charge of $7 per day until the film is returned, capped at $35.

23. Louis hires a new release DVD. The hire period for new releases is one night. Louis returns the DVD three days late. The DVD library makes Louis pay the additional hire charge of $21. The additional hire charge is subject to GST because it is consideration for the supply of the DVD.

Example 3: Further consideration for a supply

24. Tim parks his car in Cinema car park. Cinema car park is a "pay and display" car park. Tim purchases a ticket from one of the machines, guessing that he will need to pay for four hours. The hourly rate is $3, so Tim pays $12 for four hours. Tim is attending a screening of a new movie and hopes to catch up with friends afterwards. The terms and conditions of parking are printed on various signs around the car park. They state:

> Cinema car park is, by this sign, offering space for public parking. You accept this offer by parking here. All requirements of notice and acceptance are hereby waived by Cinema car park. If you park, but do not display a valid unexpired ticket, you will be charged a further $50 per day for parking. If you park here Cinema car park considers you to have accepted its offer of a parking space. Do not park here if you do not agree to these terms.

25. Tim is two hours late returning to his car. By this time, Cinema car park has issued him with a $50 charge for failing to display a valid unexpired ticket. The charge is subject to GST. The terms of the agreement are clear; the onus is on Tim to purchase a ticket for the time actually needed. By failing to purchase a ticket for the time actually needed, he is contractually bound to pay the additional charge of $50 for parking his car. The payment is further consideration for the taxable supply of the car park space.

Example 4: Payment for a breach of contract

26. Alisha parks her car in the Centre car park. The car park is operated as a "pay and display" car park. Alisha purchases a ticket from one of the machines. She estimates it will take her two hours to complete her shopping. The hourly rate is $5, so Alisha pays $10 for two hours. The terms and conditions of parking are printed on the back of the ticket. They note:

> If your vehicle does not clearly display a valid unexpired prepaid ticket then you will be parking without our consent and in breach of the terms and conditions of this agreement. As a consequence of this breach we may issue you with a parking violation notice requiring you to pay a fine of $100. You will have 28 days to pay this fine. We may also have your car towed at your own risk and expense.

27. Unfortunately for Alisha she underestimates the time it takes to complete her shopping. She returns to the car park half an hour late and discovers Centre has issued her with a parking violation notice requiring her to pay a fine of $100.

28. The charge is not subject to GST because it is a payment for breaching the contract and not consideration for the taxable supply of the parking space. No nexus or reciprocity exists between the charge and the supply of the parking space. This conclusion is supported by the fact the charge imposed bears no relationship to the actual amount that would have been payable for the extra half-hour hire of the parking space. The charge is the same whether Alisha is half an hour late, 3 hours late or 10 hours late. The charge has the characteristics of a penalty.

References

Related rulings/statements
"GST – Hire Firm Security Bonds" *Tax Information Bulletin*, Vol 26, No 7 (August 2014): 131
"GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin*, Vol 14, No 10 (October 2002): 21
Subject references
Consideration; Fine; GST; Late return charge; Library; Parking overstay charge; Penalty; Taxable supply
Legislative references
Goods and Services Tax Act 1985 – ss 2, 8 and 10
Case references
Acme Video Inc v R [1995] GSTC 49 (TCC)
Chatham Islands Enterprise Trust v CIR [1999] 2 NZLR 388 (CA)
CIR v Databank Systems Ltd (1989) 11 NZTC 6,093 (CA)
CIR v NZ Refining Co Ltd (1997) 18 NZTC 13,187 (CA)
Gulf Harbour Developments Ltd (2004) 21 NZTC 18,915 (CA)
Leigh t/a Moor Lane Video (1990) 5 BVC 757 (UK VAT Tribunal)
Rotorua Regional Airport v CIR (2010) 24 NZTC 23,979

ITEMS OF INTEREST

RELATIONSHIP PROPERTY AGREEMENTS – GST IMPLICATIONS

In *Tax Information Bulletin* Vol 12, No 5 (May 2000): 25, the Commissioner withdrew an item entitled "*GST – Matrimonial Property Agreements*", which had previously been published in *Tax Information Bulletin* Vol 1, No 6 (December 1989): 1.

The withdrawn item concerned a GST-registered sole trader transferring an interest in their taxable activity to their relationship partner as part of an agreement made under what was then known as the Matrimonial Property Act 1976 (since renamed the Property (Relationships) Act 1976 (PRA)).

The withdrawn item accepted that, due to the provisions of the PRA, the relationship partners had always jointly owned the assets and that a partnership was presumed to have existed between them. However, the item was withdrawn because the Commissioner no longer considered this was correct.

The notice of withdrawal stated that ordinary GST principles applied to these transfers. It was accepted that further clarification might be needed.

However, it appears that such situations involving relationship property agreements now occur less frequently. Indications are that relationship property agreements are more commonly used following the breakdown of a relationship or at the start of a new relationship. This change may be related to the repeal of gift duty in 2011. Also, companies and trusts are now more commonly involved as trading entities than was previously the case. The GST issues in those situations are generally less complicated. Often the taxable activity is transferred as a going concern, or shares in a company are transferred without GST consequences (being an exempt supply). This contrasts to the situation in the withdrawn item where the likelihood of an unfavourable GST outcome is greater (ie, a GST output tax liability with no corresponding right to input tax deductions may arise on the transfer of the interest in the taxable activity).

Given that the situation originally giving rise to GST issues infrequently arises in practice, the Commissioner does not intend to allocate further resources to this matter. Ordinary GST provisions and principles continue to apply.

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