Vol 27 No 10 November 2015

TAX INFORMATION Bulletin

CONTENTS

Inland Revenue
Te Tari Taake

Classified Inland Revenue – Public
ISSN 0114–7161 (Print)
ISSN 1177–620X (Online)

YOUR OPPORTUNITY TO COMMENT

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

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

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

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

Tax Information Bulletin available online only

This edition of the *Tax Information Bulletin* will be the last printed edition. If you've been receiving the *Tax Information Bulletin* in printed form, subscribe now to the email to ensure you continue to receive it.

Simply go to our website **www.ird.govt.nz/aboutir/newsletters/tib** and complete the subscription form, and/or read the *Tax Information Bulletin* online at the same link.

IN SUMMARY

Legislation and determinations

Legislation and determinations (continued)

Items of interest

Legal decisions – case notes

BINDING RULINGS

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

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)*. You can download this publication free from our website at **www.ird.govt.nz**

PRODUCT RULING BR PRD 15/02: NEW ZEALAND MĀORI ARTS & CRAFTS INSTITUTE SCHOLARSHIP

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

Name of the person who applied for the Ruling

This Ruling has been applied for by the New Zealand Māori Arts and Crafts Institute (the Institute).

Taxation Law

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

This Ruling applies in respect of s CW 36.

The Arrangement to which this Ruling applies

The arrangement is the payment of a scholarship by the Institute to students enrolled in the canoe (waka) building school known as Te Wananga a Kupe Mai Tawhiti (Te Wananga a Kupe) which runs a three-year Diploma in waka building (the Arrangement). Further details of the Arrangement are set out in the paragraphs below:

1. The Institute was established by the New Zealand Māori Arts and Crafts Institute Act 1963 (NZMACI Act). Under that Act, the purpose of the Institute—alongside its tourism function—is to train Māori in the practice of Māori arts and crafts and culture (section 14(b), NZMACI Act).
2. In 1994 a “needs analysis” of the Institute was undertaken. It was decided to focus activities on training and educating Māori. To this end, the Institute awards a Diploma in Māori arts and crafts or Māori culture generally (section 15(k), NZMACI Act).
3. The art of waka building (tarai waka) had been identified in the report, the *Health of Māori Heritage Arts* released by Creative New Zealand in 2009 as one of the two artforms diagnosed with “fragile health”.
4. To be awarded the Diploma, students must complete four modules. The modules are:
   - Module 1 Te Tua i te Rakau (The felling of trees)
   - Module 2 Te Tarai i te Waka (The building of canoes)
   - Module 3 Te Here i te Waka (The lashing of canoes)
   - Module 4 Waka Hourua (Double-hulled canoes).
5. The Institute has trained students in traditional waka building since 2013 with a limited intake of one to five students per year.

The Scholarship Agreement (the Agreement) and Scholarship Policy

6. The Institute offers a limited number of scholarships to assist students (Tauira) while they are undertaking their studies. The Agreement entered into between the Institute and its Tauira has the following features:
   - Each scholarship will be awarded to a successful applicant for the duration of the student's course at the amount of $18,200.00 per annum. The amount of the annual scholarship payments may be adjusted from time to time to reflect changes in the Consumer Price Index.
   - The Agreement sets out the hours of class attendance required of the Tauira. Terms and study periods are also specified.
   - The Agreement states that the Institute will provide a uniform and tools for the Tauira.
   - Any carvings or other items produced by the Tauira in the course of their studies are the property of the Institute.
7. The scholarship payments aim to help cover the living costs of Tauira. Tauira have generally moved from their tribal area, are young and have very few assets. All costs of training, protective clothing, tools, equipment and raw materials are covered by the Institute.
8. The Institute also has a scholarship policy which is set out below:

   Scholarship Policy

   The Institute agrees to provide the programme and in consideration the Tauira (student) agrees to attend and participate in the same in accordance with the provisions of this Agreement (the Scholarship).

> Scholarships will be awarded to a successful applicant for the duration of the student's course upon recommendation of the interview panel.
>
> Scholarships will be offered annually to successful applicants to Te Wananga a Kupe and the number of students will be determined or negotiated between the Institute and Te Wananga a Kupe.
>
> The programme has a duration of three (3) years. The Institute shall be entitled to vary and/or include any teaching and material that it deems appropriate for the programme.
>
> The Scholarship awarded for students is $18,200.00 while satisfactory attendance and participation in the programme is maintained. Award payments will be made weekly in arrears into the students bank account in an effort to assist students budget adequately for the year. Deductions as authorised by the student from time to time may also be made.
>
> The parties agree that the Institute shall be entitled to make any deductions it deems appropriate from the payments including replacement costs for tools and for any damage or destruction that the student may cause to property of the Institute its visitors, directors, employees or invitees.
>
> Students will, for the first three months of their first year with Te Wananga a Kupe, move through a probation period. During this time Te Wananga a Kupe staff and student will determine suitability/ability to cope with the course challenges.
>
> Termination of a student's scholarship may also be the result of the students' inability to complete module assignments or practice tasks prescribed within the Wananga curriculum to prescribed standards and within given time-frames.
>
> Students who wish to terminate their scholarships may do so either during the probation period or by giving one week's notice of such termination.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Scholarship payments made by the Institute to a student pursuant to the Arrangement will be exempt income of the student under s CW 36.

The period for which this Ruling applies

This Ruling will apply from the period 1 April 2015 to 31 March 2019.

This Ruling is signed by me on 7 July 2015.

Maryanne Hansen

Investigation Manager, Investigations and Advice

NEW LEGISLATION

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

TAX ADMINISTRATION AMENDMENT ACT 2015 AND LAND TRANSFER AMENDMENT ACT 2015

The Taxation (Land Information and Offshore Persons Information) Bill introduced on 22 June 2015 contained changes to help Inland Revenue enforce the tax rules around property. The changes are part of a package of measures announced by the Government in Budget 2015, to strengthen the rules around the taxation of property.

The bill received its first reading on 25 June and its second reading on 8 September. On 9 September, at the committee of the whole House stage, the bill was divided into two bills, the Tax Administration Amendment Bill and the Land Transfer Amendment Bill. Both bills received their third reading on 10 September.

The resulting Land Transfer Amendment Act 2015 and the Tax Administration Amendment Act 2015 received Royal assent on 22 September 2015.

The new Acts amend the Land Transfer Act 1952, the Tax Administration Act 1994 and the Land Transfer (Computer Registers and Electronic Lodgement) Amendment Act 2002.

NEW INFORMATION REQUIREMENTS TO IMPROVE TAX COMPLIANCE IN THE PROPERTY INVESTMENT SECTOR

Sections 2AA, 156A, 156B, 156C, 156D, 156E, 156F, 156FA, 156G, 156H, 156I, 164B, 236, and schedule 1AA of the Land Transfer Act 1952; section 23 of the Land Transfer (Computer Registers and Electronic Lodgement) Amendment Act 2002; sections 3, 24BA, and 81 of the Tax Administration Act 1994

New measures in the Land Transfer Amendment Act 2015 and the Tax Administration Amendment Act 2015 require transferors and transferees of land to provide certain tax information, including a New Zealand IRD number, when land is transferred unless an exemption applies to them.

The changes also require "offshore persons", as defined, to provide a New Zealand bank account number when they apply for an IRD number.

The changes came into force on 1 October 2015.

Background

The Income Tax Act 2007 contains provisions that impose income tax on certain property transactions, and also on rental or other income earned from property.

These rules include provisions that tax gains from property bought with the intention of disposal, and others that tax land acquired for the purposes of dealing in land. Enforcing the tax rules on non-residents can be difficult, especially those with only limited engagement with New Zealand.

In order to investigate compliance with the income tax legislation relating to property transactions, Inland Revenue has the ability to access records of land transfers in New Zealand. To date, this process has been historic, rather than in real-time. Information received may also not have given a complete picture of the activities or identity of a particular taxpayer.

To deal with these concerns, the Government announced a package of measures as part of Budget 2015 aimed at providing clearer rules for property investors, more useful information to Inland Revenue to help enforce the rules, and increased funding to investigate property compliance.

Accordingly, the following two measures came into force on 1 October 2015:

- Information will be required to be supplied to Land Information New Zealand (LINZ) upon transfer of property as part of the usual land transfer process. In particular, persons transferring any property (other than New Zealand individuals transferring their main home) must provide:
  - their New Zealand IRD number; and
  - their tax identification number from their home country if they are currently tax-resident overseas.
- To ensure that New Zealand's full anti-money laundering rules apply to non-residents before they buy a property, offshore persons must have a New Zealand bank account before they can get a New Zealand IRD number.

Key features

Transferors (such as people who are selling their property) and transferees (such as people buying a property) of property must provide the following information:

- whether the land has a home on it;
- whether the person or a member of their immediate family is a New Zealand citizen or visa-holder;
- if the person is a transferee and they or their immediate family has a work or student visa, whether they intend living on the land.

The following tax information must also be provided unless an exemption (such as the main home exemption) applies:

- the person's IRD number;
- if the person is a tax resident in another jurisdiction at the time of transfer, the name of that jurisdiction and the equivalent of an IRD number (the "tax identification number", or TIN) from that foreign jurisdiction.

A person who is not an "offshore person" as defined, and who is purchasing a property with the intention of that property becoming their main home, or selling a property that was their main home, will not have to supply the tax information. The main home information exemption is not available when the person is an "offshore person", when the property is to be or was owned by a trust, or if the person is selling their main home for the third time in a two-year period.

This information will be provided to LINZ as part of the transfer documentation and then passed on to Inland Revenue to help compliance with New Zealand's tax legislation. It could also be provided to overseas tax authorities by Inland Revenue in accordance with existing information-sharing legislation.

Aggregate data that does not identify any person may also be used for the purposes of housing policy.

An "offshore person" (as defined) will also be required to provide evidence of a fully functional New Zealand bank account as a prerequisite to obtaining an IRD number. This is to ensure that an offshore person seeking to obtain an IRD number has first complied with New Zealand's anti-money laundering and Countering Financing of Terrorism rules.

An individual is not an "offshore person" if:

- they are a New Zealand citizen **and** have been in New Zealand within the past three years; or
- they hold a New Zealand residency class visa **and** have been in New Zealand within the past 12 months.

All other individuals will be "offshore persons".

A non-individual (such as a partnership, trust or company), in general is an offshore person if it is an entity or arrangement which is:

- incorporated outside New Zealand; or
- 25 percent or more owned (legal or beneficial) or controlled by an offshore person.

Application date

The new rules came into force on 1 October 2015.

However, the new information requirements for transfers of land do not apply for transfers when both the following two conditions are met:

- the contract for the transfer is entered into before 1 October 2015; and
- the transfer is registered on or before 1 April 2016.

Detailed analysis

All references in this article are to the Land Transfer Act 1952 unless stated otherwise.

Supplying information when transferring land

Requirement to provide a tax statement

Section 156B provides that all transferors and transferees of real property who are transferring a "specified estate in land" must provide a "tax statement" before the transfer can be registered. The tax statement must be provided to LINZ, or to a certifier who will provide it to LINZ, in accordance with existing conveyancing processes as specified in section 156B(2) and (3).

The definition of a "specified estate in land" is contained in section 156A, and includes freehold estates, leasehold estates, and certain unit titles and licences to occupy, as well as any other estate in land that is declared to be a specified estate in regulations.

Section 156C states that a tax statement must contain the following:

- full name, date and signature of the transferor or transferee;
- whether the land has a home on it;
- whether the person or a member of their immediate family is a New Zealand citizen or visa-holder;
- if the person is a transferee and they or their immediate family has a work or student visa, whether they intend living on the land; and
- either:
  - the category of exemption that applies (if the transfer is a "non-notifiable transfer" for the person as defined in section 156A(2) and therefore exempt from the requirement to provide tax information);

  or

  - the tax information set out in section 156C(2) if the person's transfer is not exempt from the requirement to provide tax information.

NEW LEGISLATION

Information required for persons for whom transfer is non-notifiable

Transferees and transferors must provide the information contained in section 156C(2) unless the transaction is a "non-notifiable transfer" as defined in section 156A(2) (and therefore exempt for the purposes of section 156(2)).

The exemptions would only apply to the party identified and not to the transfer as a whole. That means that the tax information will still be required by the other party to the transfer unless the transaction is a non-notifiable transfer for that person also.

In all cases, the non-exempt person must supply their IRD number. This applies regardless of whether they are tax-resident in New Zealand or not. If the person does not currently have an IRD number, they must obtain one from Inland Revenue before they can complete the transfer.

If they are currently a tax resident of another jurisdiction, the person must state the name and country code of that jurisdiction. The list of country codes is available on Inland Revenue's website.

The person must also provide the equivalent of their IRD number in that jurisdiction—that is, the unique identifier that they use in their dealings with the tax authority in that jurisdiction.

In some cases, when a person is a tax resident of more than one jurisdiction, under the law of those jurisdictions (dual resident), a double tax agreement treaty may provide that a person is a tax resident of only one jurisdiction for the purposes of the double tax agreement treaty. In these cases, the person would have to provide their tax identification numbers for both jurisdictions.

Persons acting in different capacities

When a non-exempt person must supply information about their IRD numbers (and when applicable, their foreign equivalent of an IRD number and relevant country code), section 156C(3) provides that a person who is acting in a different capacity must provide the information as it relates to the capacity in which they are acting.

For example, when trustees of a trust are buying or selling trust property, they must provide the trust's IRD number, not their own personal IRD numbers. Similarly, partners in a partnership who are buying or selling partnership property should provide the partnership's IRD number, not their own IRD numbers. Nominees must provide the IRD number of the person for whom they are acting as nominee.

Exemptions from requirement to provide information

There are certain exemptions from the requirement to provide information. As noted above, these are "non-notifiable transfers" as defined in section 156A(2).

The first is for individuals who are not "offshore persons" who are transferring their main home.

The second is for particular transfers or parties to transfers that have been specified in regulations to the Act.

Having to supply an IRD number does not necessarily mean that tax must be paid on the sale of property. Conversely, while a person who does not have to provide their information will generally not have to pay New Zealand tax on their gain, in some circumstances they might not.

Main home information exemption

This exemption is intended for New Zealand individuals who are transferring their main home. This is provided for by section 156A(2)(a)(i) and (ii).

The definition of "main home" contained in the Land Transfer Act 1952 is very similar to the definition of "main home" contained in the Taxation (Bright-line Test for Residential Land) Bill, introduced on 24 August 2015. The policy intent was for the definitions to be broadly consistent with each other.

For the main home exemption to apply for a transferee, the land must be intended to be used predominantly for a dwelling that will be the transferee's main home.

For the main home exemption to apply for a transferor, the land must have been used predominantly, for most of the time the transferor owned the land, as a dwelling that was the transferor's main home.

The owner must intend to reside (or have resided) in the property as their main home. Accordingly, the exemption will not apply when only a family member will use or has used the property as their main home (and not the owner themselves).

Section 156A(2)(b) provides that the information exemption is not available when any one of the following applies:

- the person is an "offshore person";
- the property is to be owned via a trust (in the case of a transferee);
- the property was owned via a trust (in the case of a transferor); or
- for the sale of a property, when the main home exemption has been used twice or more in the past two years immediately preceding the date of transfer.

Transferor must have used the land for "most of the time" as their main home

In the case of a transferor, the land must have been used for most of the time that the person owns the land as their main home. This requires the property to have been used more than 50 percent of the time as their main home for the period the person owns the land.

The land does not need to have been used without interruption as their main home. For example, a main home can be rented out for short periods while the owner is on vacation or prior to settlement of the sale of the property, as long as the time is less than the private residential use.

Mixed-use properties

When a property is used as both a main home and for other commercial, investment or farming purposes, the main home information exemption will be available if most of the land is used for the home. When less than 50 percent of the property is used for the main home of the person, the main home exception will not apply.

For example, when the person's home is on a farm that is being run for profit, it is unlikely that the main home information exemption will apply because most of the land is used for commercial farming. However, if the home is on a small lifestyle block, it is likely that the main home information exemption will apply as the land is mostly used for the person's home.

When a property is used for commercial premises (for example, a shop below a house), the main home information exemption will apply if most of the premises are being used for the person's home. If most of the property is being used for the shop, the main home information exemption will not apply.

In some circumstances this may require an estimation to determine the area of land used for their private residential purposes and the area of land used for other purposes. For example, when a single property has been used by the owner partly as a residential home and partly as a rental property, the relative areas will need to be determined. For transferors, a taxpayer will have determined the relative areas in working out the tax deductions (insurance and rates, for example) that can be claimed. The determination of the areas includes any land used for the relevant purposes (for example, a backyard for the home).

Another mixed-use situation can arise when a property is being used partly as a home for the transferor or transferee, and partly as rental accommodation for other people. For example, a person owning a two-bedroom house who has one flatmate could potentially use the main home exemption, as they are likely to be using the majority of the house as their main home. However, a person who owns and lives in a boarding house with eight rooms cannot claim the main home exemption because the property is not used predominantly as their main home.

Multiple homes

If a person resides in multiple homes, only one of those properties can be their main home.

When a person has more than one place of residence, their "main home" would be determined according to which property the person has the greatest connection with. The factors that determine these connections would include:

- the time the person occupies the dwelling;
- where their immediate family (if any) live;
- where their social ties are strongest;
- the person's use of the dwelling;
- the person's employment, business interests and economic ties to the area where the dwelling is located; and
- whether the person's personal property is in the dwelling.

The greatest connection factors are similar to those used to determine if a person has a permanent place of abode under current case law. Therefore, existing guidance on the "permanent place of abode" test should assist in determining which property the person has the greatest connection with.

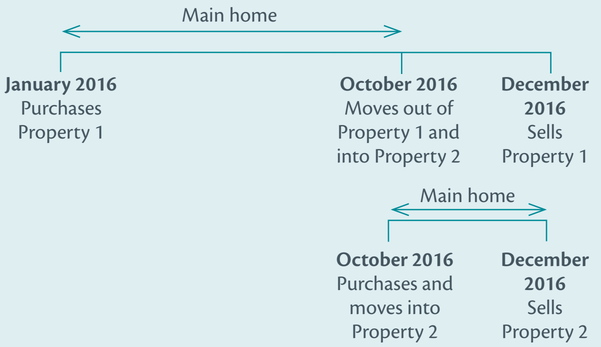
Time at which test is applied

The time that the test should be applied is at the date of transfer. Occasionally this will mean that a person can use the main home information exemption for two properties sold at the same time.

An example is when a person purchases a house intending to live in it and then moves into a new home while trying to sell the original home.

The ownership overlap of the properties will not mean the original home fails to satisfy the requirements to be a main home for the previous period. If the two properties were sold at the same time, the owner will be able to use the main home exception for the purchase and sale of the original house, and also for the purchase and sale of the second property (if each transaction satisfied the requirements to be a main home at the date of transfer).

Example: Main home exception for multiple properties



The main home exception is available for both properties. Property 1 was the main home for the majority of the time that person owned Property 1. Property 2 was the main home for the entire time it was owned (October to December 2016).

Different co-owners can have different main homes

The test applies for each transferor or transferee. This means that different co-owners can have different main homes. For example, a person living in one city could potentially have a different main home from their spouse living in another city.

Offshore persons

Section 156A(2)(b)(iv) will provide that the main home exemption is not available to "offshore persons" (defined in section 3 of the Tax Administration Act 1994).

This means that the main home exemption will be available to a person only if one of the following applies:

- they are a New Zealand citizen or permanent visa holder who is currently present in New Zealand; or
- they are a New Zealand citizen who is not currently present in New Zealand but they have been away from New Zealand for less than three years; or
- they are a permanent resident visa holder who is not currently present in New Zealand but they have been away from New Zealand for less than one year.

All other persons who are transferring a property must supply their IRD number, and if they are a current tax resident of another country, their equivalent of an IRD number and the country code of the other country.

Trusts

If the property being transferred was or will be trust property, section 156A(2)(b)(i) and (ii) provides that the main home information exception cannot be used. This means that the trustees of a trust will need to provide the trust's IRD number (and foreign equivalent of an IRD number and country code, if applicable) when transferring trust property.

Persons selling their main home a third time within two years

Section 156A(2)(b)(iii) provides that a person who has transferred their main home at least twice in the past two years must provide their IRD number (and foreign equivalent of an IRD number and country code, if applicable) if they transfer their main home a third time within that two-year period. This is to address the situation where a person has a regular pattern of buying and selling a property in which they live, for profit. The person may be taxable under existing law on gains from the sale of these properties. Collecting information in relation to those who have sold their home for the third time within two years is intended to help Inland Revenue identify those situations.

Examples of main home information exemption

Example 1: Main home

George buys his first home in Seymour Street in 2016. However, his neighbours complain about the noise when he plays his drum kit, so he decides to sell it and buy a new home with better soundproofing. When he puts his Seymour Street house on the market he is pleasantly surprised to discover that his house has risen in value. He has an offer accepted on a new house in Taradale Street. George does not need to provide his IRD number for the sale of the Seymour Street property, which he lived in as his main home, or the purchase of the Taradale Street property, which is to be his main home.

Example 2: Holiday home

Lisa rents an apartment in Wellington, where she lives with her son. The apartment is close to her office from which she runs her consulting business fulltime. She is a member of a local tramping club and is on the Board of Trustees of her son's school in central Wellington.

She owns a house on Lake Taupo with views over the lake. She does not let the Lake Taupo property out when she is not using it. She spends four weeks with her son in this property here over Christmas and New Year, and also uses the property for about five weekends during the ski season.

When Lisa sells the Lake Taupo property, she cannot use the main home exemption because it is not the property with which she has the greatest connection, taking into account the factors listed above under the section "Multiple homes".

Example 3: Two properties

Mr and Mrs Brown and their children live in a house on a small lifestyle block in Oamaru. Mrs Brown works in Christchurch for three days a week, and works from the Oamaru house two days a week while her husband looks after the children fulltime. Mrs Brown plans to buy an apartment in Christchurch city. She will live in that apartment while she works in Christchurch.

Taking into account the fact that the majority of Mrs Brown's time is spent at the Oamaru house, and her family is located at the Oamaru house, the main home information exemption will not apply in relation to Mrs Brown's Christchurch apartment as it is not the home with which she has the greatest connection, and she will have to supply her IRD number in relation to the purchase of that property.

However, if Mr and Mrs Brown were to sell their Oamaru property, they would not need to provide their IRD numbers in relation to that sale because that property was their main home.

Example 4: Offshore person

Sarah is a New Zealand citizen who has been living in the United Kingdom (UK) for the past 10 years. Before returning to New Zealand, she decides to buy a house in Te Awamutu to live in. As she is an "offshore person" at the time she purchases the house, she cannot use the main home information exemption for this property and she will need to supply her IRD number in relation to the purchase of that property. Because she is a tax resident of the UK at the time that she purchases the property, she will also need to supply her UK National Insurance number (which is the equivalent to a New Zealand IRD number), and the UK country code.

Example 5: Investment property

Tom and Barbara are selling their property, which they used as their main home, to Jerry and Margo, who are buying it to use as an investment property.

The transfer is a non-notifiable transfer for Tom and Barbara. They are both New Zealand citizens and have been present in New Zealand within the last three years, and are selling their main home.

However, the transfer is not a non-notifiable transfer for Jerry and Margo. Jerry and Margo live in the UK but are New Zealand citizens, and have visited New Zealand within the last three years. However, they are not buying their main home. They must therefore supply the tax information required under section 156C(2).

Jerry and Margo must supply their New Zealand IRD numbers. Because they are both tax residents of the UK, they must also supply their UK National Insurance numbers.

Jerry is also a tax resident of France under France's domestic tax laws because he owns a holiday home there. He therefore also needs to provide his French tax identification number. (Although there is a double tax treaty between France and the UK, and that double tax treaty provides that Jerry is a resident of the UK only, he still needs to provide both his French tax identification number and his UK National Insurance number.)

Example 6: Multiple dwellings

Tom buys an apartment block on a single title. He lives in one of the apartments as his main home and rents out the remaining six apartments. Tom sells the apartment block to a third party. Tom will have to provide his IRD number on the sale of the apartment block because the land (contained on the single title) was not used predominantly as his main home. The majority of the land was used as rental property.

Example 7: Lifestyle block

Paul purchases a two hectare block of former farmland and builds a house on it. Paul lives in the house as his main home with his family. The remaining land is used by the family to keep some family horses to ride and to run a handful of sheep to keep the grass down. The main home exception will apply and Paul will not need to supply his IRD number when he purchases or sells the land.

Example 8: Mixed use – apartment attached to factory

Melissa intends to purchase a large factory with a small apartment attached. Melissa intends to live in the apartment as her main home. Melissa must supply her IRD number at the time she acquires the property because she does not intend to use the land predominately as her main home.

Example 9: Mixed use – country store and house

Judy owns a country store that has living quarters attached. She lives in the living quarters and runs a retail business from the front half of the property. She estimates that the retail business uses 45 percent of the property and claims expenses (for example, insurance and rates) on that basis against the retail income. Judy sells the property. She does not need to provide her IRD number because she has used the property predominantly (55 percent) as her main home during the time she has owned the property.

Example 10: Mixed use – purchase of fish and chip shop

Brandon intends to buy a fish and chip shop with an attached dwelling. Brandon will need to determine the total area of the different parts of the property to determine whether he intends to use the property predominantly for his main home, and so whether he needs to supply his IRD number as part of the purchase. (Brandon will need to make an estimation of the total area in the future in any event to determine the deductions that can be claimed against his retail income.) Brandon estimates that he will use the property (building and surrounding land) 60 percent for the fish and chip shop. He will, therefore, need to provide his IRD number on purchase of the property.

Example 11: Purchase of lifestyle block (change in use)

Amy and Chris decide to move from the city to the country. They buy a 15 acre (six hectare) block. They intend to purchase some livestock to keep the grass down and the freezer full.

At the time of acquisition, they would not need to supply their IRD number as the main home exemption would apply.

After three years, the couple decide to supplement their income by leasing out all but one of the paddocks for horse grazing. As a result, the area that they use for their own purposes does not exceed the area of the leased paddocks. They continue to lease out most of the paddocks for horse grazing for the next five years, at which point they decide to sell the property.

When they sell the property, the main home exemption will not apply to them because the majority of the land was not used for their main home for the majority of the time that they owned it.

Information exemptions (non-notifiable transfers) under regulations

Sections 156A(2)(iii) and 236(l)(ha)(ii) provide that particular types of transfers or parties to transfers can be "non-notifiable" transfers under regulations to the Act. In these cases the IRD number, and where applicable, a tax identification number and country code are not required.

In order for a type of transfer, or party to a transfer, to be specified in regulations, section 236(4) provides that the Minister for Land Information must be satisfied that the type of transfer or party to a transfer meets the following criteria:

- collecting this information would be impractical or involve high compliance costs; or
- the transfer would represent a low tax avoidance risk.

The exemptions would only apply to the party identified and not to the transfer as a whole. That means that the tax information will still be required by the other party in the transfer unless the transaction is a non-notifiable transaction for them too.

Cabinet has approved regulations that will exempt transfers in the following situations.

Mortgagee sales

Where a transfer is the result of a mortgagee sale, a rating sale under the Local Government (Rating) Act 2002, a court-ordered or statute-ordered sale, the transferor does not need to provide an IRD number. This is because the transferor in this circumstance is the mortgagee or creditor and there is a low risk of tax avoidance in this context.

Transfers from executors

In the case of death, the executors of the person's estate are exempted from the requirement to provide an IRD number. The rationale for this exemption is that estate sales will not be taxed under the proposed bright-line test, and requiring all executors to get an IRD number would also add compliance costs in a situation when there is no choice about the vehicle used for transferring property.

Public and local authorities

Tax-exempt public authorities and tax-exempt local authorities, as defined in the Income Tax Act 2007, would not need to provide an IRD number when transferring land. This definition includes departments and departmental agencies and local authorities but not wider Crown Entities or Council Controlled Organisations. It will include any land held by the Crown. As they are tax-exempt there is no need for tax information.

Offence to supply misleading or false tax information

Section 156E provides that a person who knowingly, or with intent to deceive, gives false or misleading tax information, commits an offence. A person who commits such an offence is liable to a fine of up to $25,000 if the conviction is a first-time offence, and a fine of up to $50,000 for every subsequent offence.

A person who provides information that they genuinely believe to be true but which is not in fact correct will not be committing an offence.

Correction of errors or omissions

Section 156D provides a procedure for an omission or error that was contained in a tax statement provided to LINZ to be corrected. Such omissions or errors do not affect the validity of any registration of transfer instrument.

Information disclosure and retention

Section 156H provides that tax information must not be disclosed unless authorised or required by law.

Section 156F requires LINZ to supply Inland Revenue with the tax information and the details of the related property transaction that it collects. Section 156I of the Land Transfer Act and section 81 of the Tax Administration Act 1994 permit tax information to be disclosed between authorised persons in specified circumstances, which is intended to allow for information matching between Inland Revenue and LINZ in relation to the information collected by LINZ.

Section 156F also permits the chief executive of LINZ to release or to give tax information to any person who requests it, provided that the information is given in aggregate form only and in a manner that prevents any person, estate in land, or transaction from being identified.

Under section 156G, certifiers and LINZ must hold tax statements for 10 years. A copy of a statement must be provided to the Commissioner of Inland Revenue if requested in writing.

Regulations providing for exemption from requirement to provide tax statement

As noted above, section 156B provides that all transferors and transferees of real property must provide a tax statement before the transfer can be registered.

Section 236(1)(ha)(i) provides for regulations to be made to exempt certain types of transactions from the requirement to complete a tax statement if it would be impractical or involve high compliance costs, or when there is a low risk of tax avoidance.

Cabinet has approved regulations to exempt transfers of Māori Land as defined by Te Ture Whenua Māori Act 1993 (Māori customary land and Māori freehold land) for practicality reasons. There are often many owners and contacting them all is difficult, if not impossible. Cabinet has approved regulations to exempt transferees from the requirement to complete a tax statement where the transfer is a part of the Treaty settlement process. Again, in many cases it would be impractical to collect information from owners.

Except in the case of Māori land, the exemptions would only apply to the party identified and not to the transfer as a whole. That means that a tax statement will still be required by the other party in the transfer unless they too are exempted by regulation.

Regulations providing for other estates in land to be covered by the tax information requirement

Regulations will be able to be made to include transfers of other estates in land to be covered by the tax information requirement, where these are economically equivalent (see section 236(l)(hb)). No such regulations are currently under consideration.

New Zealand bank account requirement

Section 24BA(1) of the Tax Administration Act 1994 provides that the Commissioner must not allocate a tax file number (commonly known as an IRD number) to an offshore person unless she first receives a bank account number for that person.

The main features of the rule are:

- the definition of "offshore person"; and
- the definition of "bank account number".

Offshore person

The definition of "offshore person" applies both to individuals and non-individuals (for example, trusts and companies).

For individuals, a New Zealand citizen or person that holds a residence-class visa granted under the Immigration Act 2009 will generally not be classed as an offshore person unless:

- in the case of citizens, they have not been in New Zealand within the last three years; and
- in the case of residents, they have not been in New Zealand within the past 12 months.

A non-individual will be an "offshore person" if they would be an overseas person under section 7(2)(b) to (e) of the Overseas Investment Act 2005 (modified to include the test for individuals described above). This test looks through structures that are New Zealand tax-resident and looks at their underlying ownership or control. The test is necessary to prevent offshore individuals avoiding the rule by interposing a New Zealand-resident structure.

Generally speaking this means a non-individual will be treated as being "offshore" if:

- It is a body corporate (such as a company) and:
  - it is incorporated outside New Zealand; or
  - 25 percent or more of its shares are owned by a body corporate incorporated outside New Zealand; or
  - an offshore person has (or offshore persons have):
    - 25 percent or more of any class of securities;
    - the power to control the composition of 25 percent or more of its governing body; or
    - the right to exercise or control 25 percent or more of the voting power.
- It is a partnership or other unincorporated body of persons (other than a trust) and:
  - 25 percent or more of its partners or members are offshore persons; or
  - an offshore person has (or offshore persons have) a beneficial interest in or entitlement to 25 percent or more of the profits or assets (including on winding up); or
  - an offshore person has (or offshore persons have) the right to exercise or control the exercise of 25 percent or more of the voting power at a meeting.
- It is a trust and an offshore person (or offshore persons):
  - constitute 25 percent or more of its governing body; or
  - has or have a beneficial interest in or entitlement to 25 percent or more of the trust property; or

NEW LEGISLATION

- are 25 percent or more of those that have the right to amend or control the amendment of the trust deed; or
- are 25 percent or more of those having the right to control the composition of the trust's governing body.

- It is a unit trust and an offshore person (or offshore persons) and:
  - is or are the manager or trustee, or both; or
  - has or have a beneficial interest in, or entitlement to, 25 percent or more of the trust property.

Bank account number

A "bank account number" is an identifying number of an account at either a "registered bank", as defined in the Reserve Bank of New Zealand Act 1989[1], or a "licensed non-bank deposit taker", as defined in the Non-bank Deposit Takers Act 2013. The Reserve Bank publishes lists of both types of entity on its website.

The bank account must be one for which customer due diligence (under the anti-money laundering rules) has been completed. This is to ensure that the relevant identity checks have actually been performed on the person applying for the IRD number. The account must be a current account (a person cannot use the details of a closed account).

The account number submitted to the Commissioner must be an account held by the IRD number applicant.

The bank account requirement applies only in instances when a person has applied for an IRD number. This is so that the current practice of the Commissioner allocating IRD numbers as an administrative matter in some cases will continue.

Becoming an offshore person

Section 24BA(2) of the Tax Administration Act 1994 is intended to prevent the bank account requirement being circumvented by, for example, a New Zealand company being established, obtaining an IRD number and then being sold to an offshore person. The proposed section requires a person to give their bank account number to the Commissioner immediately upon becoming an "offshore person". However, this requirement to provide a bank account number at this later time applies only to non-individuals. This means that, for example, a New Zealand citizen who emigrates will not be obliged to provide a bank account number after being away for three years.

A person who has already provided a current bank account number to the Commissioner of Inland Revenue does not need to do so again if they become an "offshore person".

Penalties for non-compliance

No new penalties are included as part of these amendments. If an offshore person does not provide a bank account number they will not be issued an IRD number. Existing penalties may apply in certain instances, such as for the requirement to provide a bank account number upon becoming an offshore person. In such cases, failing to provide information to the Commissioner of Inland Revenue when required to do so by a tax law is an offence under sections 143 and 143A of the Tax Administration Act 1994.

[1] This definition is already contained in section YA 1 of the Income Tax Act 2007, and so is incorporated in the Tax Administration Act through the operation of section 3(2) of that Act.

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 15/08: INCOME TAX – TAX TREATMENT OF ALLOWANCES PAID TO CHAINSAW OPERATORS

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

This Question We've Been Asked is about ss CE 1 and CW 17.

This item replaces the items "Allowances for Chain Saw Operators" (*Public Information Bulletin* No 89, January 1977) and "Chainsaw Reimbursing Allowances" (*Public Information Bulletin* No 175, July 1988). They were identified as being out of date and needing to be replaced during a review of *Public Information Bulletins* and *Tax Information Bulletins* published before 1996. For more information about the review, see "Review of Public Information Bulletins" *Tax Information Bulletin* Vol 23, No 1 (February 2011), at 116.

Question

1. Can an employer pay a tax-free allowance to an employee for using a chainsaw in their work?

Answer

2. Yes, but only to the extent that the allowance is a reimbursing allowance for expenses the employee incurs or is likely to incur in using their own or their employer's chainsaw for work. Any amount paid to the employee over the reimbursing allowance is taxable to the employee as employment income and subject to PAYE.

Explanation

What is an allowance?

3. An allowance is a payment of an agreed amount by an employer to an employee. It is paid either on a regular basis (such as daily or weekly) or when certain events happen. It is taxable to the employee as employment income under s CE 1(1)(a) unless an exemption applies.

4. There are two main types of allowances, namely benefit allowances and reimbursing allowances. Benefit allowances are taxable to the employee as employment income under s CE 1(1)(a) and subject to PAYE. However, reimbursing allowances may be exempt from income tax under the general exemption in s CW 17.

What is a reimbursing allowance?

5. A reimbursing allowance is an allowance paid by an employer to an employee for operating expenses that an employee incurs or is likely to incur in connection with their employment.

6. A reimbursing allowance is not an exact reimbursement of expenditure. Operating expenses are expenses that the employee would be allowed a deduction for if the employment limitation did not exist (s CW 17(2)). Under s CW 17(2B) the expenditure will be treated as incurred in connection with an employee's employment if it is a necessary expense incurred in doing the job from which they earn income.

7. For a chainsaw reimbursing allowance to be paid tax-free to an employee under s CW 17(2), the employee must incur, in connection with their employment, operating expenses on a chainsaw:
   - owned and operated by the employee in their work; or
   - owned by the employer and operated by the employee in their work.

   The Commissioner acknowledges that it is unlikely that an employee will incur operating expenses on their employer's chainsaw in practice. Where the employee does not incur operating expenses on their employer's chainsaw, they cannot receive a chainsaw reimbursing allowance tax-free.

What is a benefit allowance?

8. A benefit allowance is an allowance paid by an employer to compensate an employee for the conditions of their service, such as using a dangerous piece of equipment or working in a dangerous or dirty environment or in a remote location. Unlike a reimbursing allowance, a benefit allowance is taxable to the employee as employment income under s CE 1(1)(a) and subject to PAYE.

9. If the allowance paid is a mixture of a reimbursing allowance and a benefit allowance, then only that part of the total allowance that is a reimbursing allowance can be paid tax-free.

What types of expenses can a chainsaw reimbursing allowance cover?

10. A chainsaw reimbursing allowance can cover operating expenses such as interest, insurance, repairs and maintenance costs (including labour and parts), bars and consumables (such as chains, petrol, two-stroke oil and chain oil).

11. In setting the allowance amount, the employer can estimate the total amount of expenditure an employee is likely to incur in using their chainsaw at work. Section CW 17(3) allows employers to make a "reasonable estimate" of the amount of expenditure likely to be incurred by an employee or a group of employees.

12. A reasonable estimate is one that has some basis. For example, the estimate might be based on actual historical data, industry standard information or employee survey information. Employers must retain sufficient information about how the estimate was calculated to substantiate the allowance amount. Employers should review their estimates periodically to ensure they remain "reasonable".

Can an amount for depreciation be paid as part of a chainsaw reimbursing allowance?

13. An employee who buys their own chainsaw cannot be reimbursed tax-free for the purchase price of the chainsaw because the expenditure is of a capital nature. However, under s CW 17(4), a chainsaw reimbursing allowance can include an amount for the depreciation of the chainsaw where the employee owns the chainsaw. The depreciation amount included in a chainsaw reimbursing allowance is not meant to be an exact reimbursement of the cost of the chainsaw. It is supposed to be a reasonable estimate of the depreciation loss likely to be suffered by an employee from using their chainsaw at work. Employers can therefore factor into the chainsaw reimbursing allowance paid to their employees an estimated amount representing the depreciation loss likely to be suffered by the employees using their own chainsaws in their employer's business. This estimated amount should be based on the depreciation rates for chainsaws set by the Commissioner.

14. The depreciation rate for chainsaws of professional loggers (such as cross-cutters) is 100%. This means that the full cost of the chainsaw can be written off as depreciation and factored into the amount of the chainsaw reimbursing allowance for professional loggers annually.

15. The Commissioner understands that the forestry industry is far more mechanised today than in the past. The industry is increasingly using mechanised harvesters, static de-limbers and the like. This means that the use of chainsaws has become less prevalent, and the number of professional loggers has decreased as a result. The depreciation rate for chainsaws of forestry workers other than professional loggers, as well as of arborists and other employees using their chainsaws for work, is 67% (for both the straight line and diminishing value calculations). This means that a proportion (up to 67%) of the cost of the chainsaw can annually be factored into the chainsaw reimbursing allowance paid to such workers to compensate for the depreciation of the chainsaw.

16. An amount for the depreciation of a chainsaw can be included in the chainsaw reimbursing allowance because depreciation is an operating charge that employees are likely to incur in connection with their employment in using their chainsaws at work. To the extent that any amount paid for depreciation of a chainsaw exceeds the amount allowed under the Act, it cannot be paid tax-free under s CW 17. This is because it will be reimbursing expenditure of a capital nature. It is therefore subject to the capital limitation and would not be deductible to the employee.

What happens when the employee only uses the chainsaw some of the time or not at all?

17. For a chainsaw reimbursing allowance to be tax-free under s CW 17, it must be a reasonable estimate of the operating costs an employee is likely to incur in using their chainsaw for work. For professional loggers, such as cross-cutters, those costs are likely to be greater than for other employees who use their chainsaws at work, such as arborists. These other employees might also incur some operating costs, although these costs are expected to be less than professional loggers' costs. In the case of those employees who are required to bring a chainsaw to work but do not use it regularly (or do not use it at all), such as machine operators, the level of costs that can be legitimately reimbursed with a chainsaw reimbursing allowance will be much less. This is because, apart from depreciation, these employees are likely to incur minimal expenses (if any) in using their chainsaw at work.

18. If all these employees (eg, cross-cutter, arborist, machine operator) are paid the same level of chainsaw reimbursing allowance, the whole allowance may be tax-free to the cross-cutter, but will be split between a reimbursing allowance (tax-free) and a benefit allowance (taxable to the employee as employment income) for the others.

19. Any chainsaw allowance paid to an employee who neither owns nor uses a chainsaw at work at all is taxable to the employee as employment income and subject to PAYE. This is because the exemption in s CW 17 does not apply.

What about other reimbursing allowances paid to forestry workers?

20. The principles discussed above relating to the tax treatment of allowances also apply to other allowances that might be paid in the forestry sector.

Examples

21. The following examples are included to assist in explaining how the law applies.

Example 1: Chainsaw reimbursing allowance

22. Ian is employed by Big Trees Logging Ltd as a cross-cutter. Ian provides his own chainsaw that he uses for work purposes on a daily basis. Big Trees Logging Ltd pays Ian a daily chainsaw allowance for the use of his chainsaw at work. In arriving at the amount of the allowance, Big Trees Logging Ltd estimates the GST inclusive amount of expenditure likely to be incurred by its cross-cutters, including reasonable estimates of:
   - depreciation (using a depreciation rate of 100%);
   - interest;
   - insurance;
   - repairs and maintenance (labour and parts);
   - bars and chains; and
   - consumables.

23. The reasonable estimates of these items of expenditure take into account the size and expected usage of Ian's chainsaw, and are in line with industry standard costings. This daily chainsaw allowance is exempt and not taxable to Ian because it reimburses Ian for expenditure that would be deductible to him if the employment limitation did not exist.

24. If Ian is required to provide a spare chainsaw, Big Trees Logging Ltd can also pay Ian a daily chainsaw allowance for providing the spare chainsaw. However, the reasonable estimate of expenditure Ian is likely to incur for the spare chainsaw will be much less than for Ian's first chainsaw. This is because Ian's expenses on the second chainsaw are likely to be minimal.

Example 2: Chainsaw not used for work

25. Todd is also employed by Big Trees Logging Ltd as a machine operator. He is required to bring his chainsaw to work every day but, unlike Ian, Todd seldom uses the chainsaw for his work. Big Trees Logging Ltd pays Todd the same daily chainsaw allowance as that paid to Ian in example 1.

26. Todd cannot be paid the same allowance as Ian tax-free as it is not a reasonable estimate of the costs Todd is likely to incur for the use of his chainsaw. Any amount paid to Todd over a reasonable reimbursement amount will be taxable to Todd as employment income and subject to PAYE.

Example 3: Chainsaw not owned by employee

27. Graham is employed as an arborist. He is required to use a chainsaw on a daily basis for his work. His employer supplies the chainsaw and pays for all consumables and outgoings, including spare parts and repairs and maintenance costs for the chainsaw.

28. Any chainsaw allowance paid to Graham is not an allowance paid to reimburse Graham for any expenditure because he is not likely to incur any expenditure for the use of the chainsaw. It is therefore taxable to Graham as employment income and subject to PAYE because the exemption in s CW 17 does not apply.

Example 4: Chainsaw owned by employee but employer pays for some outgoings

29. Chris is employed as a tree-feller. She is required to use her own chainsaw for work on a daily basis, but her employer pays for the fuel, two-stroke oil and chain oil for the chainsaw.

30. In setting the level of the chainsaw allowance, Chris's employer needs to consider what expenses Chris is likely to incur for the use of her chainsaw. If her employer includes the cost of the fuel and chain oil in the allowance paid to Chris, the amount representing these costs is a benefit allowance, as Chris will not incur these expenses in using her chainsaw. To the extent that the allowance provides a benefit to Chris, the allowance will be taxable to her as employment income and subject to PAYE.

Example 5: Chainsaw reimbursing and benefit allowance

31. Nikau is employed as a cross-cutter and uses his chainsaw for work in his employer's business on a daily basis. In addition to his salary, Nikau's employer pays Nikau a daily chainsaw allowance. The amount of the allowance includes a reasonable estimate of the operating costs Nikau is likely to incur in using his chainsaw at work, a depreciation

amount using a depreciation rate of 100% and an amount to compensate Nikau for working in a dangerous outside environment.

32. The part of the total daily allowance paid to compensate Nikau for working in a dangerous outside environment is a benefit allowance. It is not an allowance paid to reimburse Nikau for any expenditure. It is therefore taxable to Nikau as employment income and his employer should deduct PAYE from that amount. The balance of the allowance paid to Nikau, being a reimbursement allowance, is exempt and not taxable to Nikau.

References

Related rulings/statements
"Allowances for Chain Saw Operators" (*Public Information Bulletin* No 89, January 1977)
"Chainsaw Reimbursing Allowances" (*Public Information Bulletin* No 175, July 1988)
Subject references
Allowance, chainsaw
Legislative references
Income Tax Act 2007 – ss CE 1(1)(a) and CW 17

QB 15/09: INCOME TAX – INSURANCE – PERSONAL SICKNESS AND ACCIDENT INSURANCE TAKEN OUT BY EMPLOYEE WITH EMPLOYER PAYING THE PREMIUMS ON EMPLOYEE'S BEHALF

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

This Question We've Been Asked is about ss CA 1, CA 2(2), CE 1(1), CE 5, CE 11, CW 34, CX 4, DA 1, DA 2, RD 2, RD 3, RD 5(2) and the definition of "salary or wages" in s YA 1.

1. This Question We've Been Asked (QWBA) considers the income tax treatment of personal sickness or accident insurance policies. Some personal sickness or accident insurance policies include elements of income protection insurance. There are specific provisions in the Act that apply only to income protection insurance, so income protection insurance may have a different tax treatment to other personal sickness or accident insurance.
2. This QWBA does not consider the treatment of payments to or from sickness, accident, or death benefits funds.
3. This QWBA also does not consider the treatment of weekly compensation purchased under s 223 of the Accident Compensation Act 2001.

Question

4. What is the income tax treatment of a personal sickness or accident insurance policy that is:
   - taken out by an employee (the employee is the policy holder), and
   - the premiums are paid by the employer on the employee's behalf?

Answer

5. The employer will generally be entitled to a deduction for the premiums paid.
6. The amount of the premiums paid for income protection insurance will not be subject to PAYE. The amount of premiums paid for other personal sickness or accident insurance policies will be treated as salary or wages and, therefore, subject to PAYE. Fringe Benefit Tax will not apply because the policy belongs to the employee.
7. Amounts paid out (or that an employee is otherwise entitled to) under income protection insurance policies will be income under s CE 11. Amounts paid out (or that an employee is otherwise entitled to) under other personal sickness or accident policies will be income only if they are income under ordinary concepts (s CA 1(2)). Amounts that are not income under ordinary concepts will not be subject to tax.
8. Amounts that are income under s CE 11 or s CA 1(2) will be exempt income if they are payments:
   - made to a person because they (or another person) are incapacitated for work; and either
     - paid by a friendly society (s CW 34(2)(a)); or
     - **not** calculated according to a loss of earnings (s CW 34(2)(c)).
9. If the payment does not meet these criteria, it will be assessable income.

Explanation

10. Inland Revenue recently undertook a review of all *Public Information Bulletins* (see **http://www.ird.govt.nz/technical-tax/pib-review/**). During that review two items on the income tax treatment of insurance in an employment context were identified as being out of date. The two items are "Staff insurance schemes" (*Public Information Bulletin* No 70 (December 1972): 11) and "Life and accident insurance policies" (*Public Information Bulletin* No 106 (July 1980): 2). Those PIBs covered a number of different scenarios. We intend to replace the PIBs with a series of QWBAs covering common scenarios.
11. This QWBA considers the situation where an employee takes out a personal sickness or accident insurance policy and the employer pays the premiums. It does not cover the situation where an employer takes out a sickness or accident insurance policy for the employee's benefit (see QB 15/10 for discussion of that situation).
12. There are many different types of insurance policies that could be sickness or accident insurance (or could include an element of personal sickness or accident insurance). These include medical insurance, income protection insurance, accident insurance, and trauma or critical illness policies. Pay-outs under these insurance policies can be periodic or lump sum and can be calculated in a variety of ways.
13. Where only part of a policy comes within a particular definition, it may be necessary to apportion premiums between different types of insurance. Similarly where a pay-out under a policy is made for more than one thing, apportionment of the receipt may be required.

Deductibility of premiums for employer

14. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable (and/or excluded) income (s DA 1). Section DA 2 sets out some limitations on deductibility. For example, expenditure that is capital in nature, or expenditure incurred in deriving exempt income, is not deductible (s DA 2(1) and (3)).

15. In most cases, salary and wage costs will be deductible because they will satisfy the nexus test in s DA 1 and none of the general limitations will apply. The payment of a sickness or accident insurance premium for an employee that is paid in connection with the employee's employment is a business cost just like salary or wages. Therefore, provided the costs of an employee's salary or wages are deductible, the costs of paying the insurance premiums will be too.

Whether amount of premium paid is taxable in the hands of the employee

16. An employee's income includes "expenditure on account" of that employee (s CE 1(1)(b)). Expenditure on account of an employee means a payment **made by an employer** relating to expenditure **incurred by an employee** (or to be incurred by an employee) (s CE 5(1)). This is subject to certain exceptions (in s CE 5(3)).

17. The only potentially relevant exclusion in this context is s CE 5(3)(j). Section CE 5(3)(j) applies to premiums for income protection insurance that an employer is liable to make a contribution towards for the benefit of an employee. Where a personal sickness or accident policy is also (or also includes) income protection insurance, s CE 5(3)(j) may be relevant.

18. In the situation covered by this QWBA, the **employee** has a legal obligation to the insurance company to pay the insurance premiums. Therefore, the amount of the insurance premiums is incurred by the employee. The **employer** is paying the premiums to the insurance company. Therefore, the payment of the insurance premiums meets the definition of expenditure on account of the employee under s CE 5(1).

19. To the extent that the premium paid is:
    - for "income protection insurance"; and
    - the employer has a liability to pay (or make a contribution towards) that premium,

    then the payment of the premium will not be expenditure on account of the employee. Premiums paid for income protection insurance are not subject to PAYE (ss CE 5(3)(j)).

20. In all other cases the payment of the premium will be expenditure on account of the employee. A payment of expenditure on account of an employee is part of the employee's "salary or wages" (s RD 5(2)). A payment of salary or wages is a "PAYE income payment" (s RD 3). Therefore, the PAYE rules apply and the amounts are subject to PAYE. The amount of the premiums needs to be grossed up before PAYE is calculated. That is, the amount of the premium paid is the amount net of tax.

21. As the payment of the premium is assessable income to the employee, the FBT rules will not apply (s CX 4).

22. There are also other potential implications of having the gross amounts of the premiums included in an employee's salary or wages. For example, there are various other circumstances where obligations, eligibility, or entitlements may be calculated based on an employee's salary or wages (for example KiwiSaver and Working for Families Tax Credits).

Treatment of proceeds to the employee

23. Whether a payment made under an insurance policy is taxable will depend on what it is paid for. Some payments will not be income (under a specific provision or ordinary concepts) and, therefore, will not be taxable. Payments that are "income" may be either taxable or exempt income depending on the circumstances. The following discussion is intended to assist with determining how a payment under an insurance policy should be treated.

Is the payment to the employee income?

24. If a personal sickness or accident insurance policy is (or includes) income protection insurance, s CE 11 may apply. Payments made under a policy of income protection insurance where an employer is liable to pay or contribute to the premiums are income to the employee under s CE 11.

25. There are no specific provisions that apply to make payments under other personal sickness or accident insurance policies income. Therefore, payments under these insurance policies will be income only if they are income under ordinary concepts (s CA 1(2)).

26. Whether a payment under an insurance policy is income or not will depend on the relationship between the payer and the recipient and the purpose of the payment (*Reid v CIR* (1985) 7 NZTC 5,176). Where a payment is made to replace income which the recipient would otherwise have earned or where the purpose of the payments is to provide the recipient with amounts to meet their living expenses, the payments are likely to be income. Payments that are

regular or recurring are much more likely to be income (*Reid*). However, a one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).

27. Therefore, the payments that are most likely to be income are payments that are intended to compensate an insured person for lost income (whether periodic, or lump sum) and other regular or periodic payments intended to help the insured person meet their living expenses. Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made to compensate a person for the loss of a limb, or a payment reimbursing medical expenses).

28. Payments that are not "income" (either under s CE 11 or s CA 1(2)) will not be taxable. If a payment is "income", it is necessary to consider whether it is assessable income or exempt income.

Is the payment exempt income of the employee?

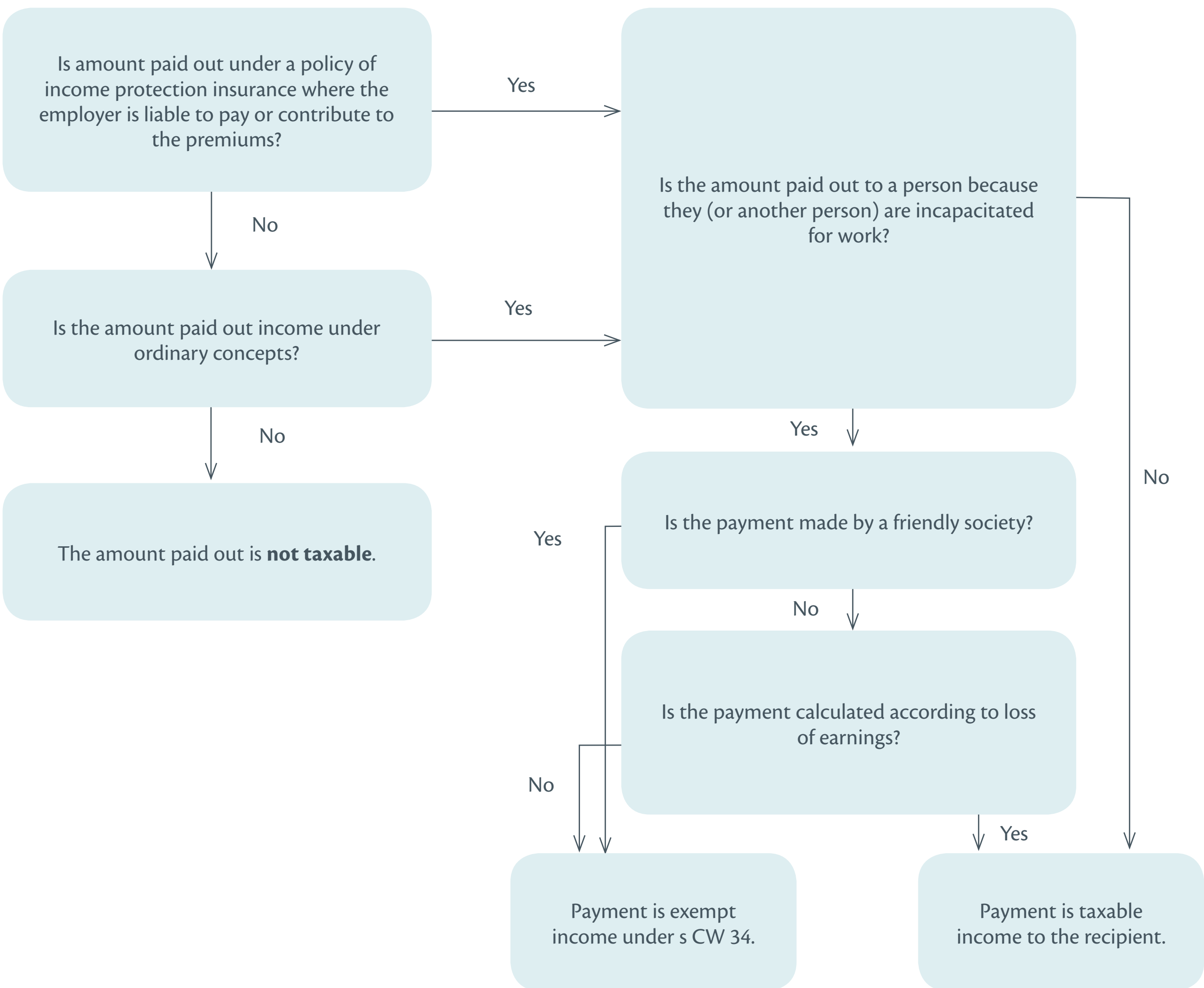
29. The relevant exemption provision is s CW 34. A payment of income made under a policy of personal sickness or accident insurance will be exempt under s CW 34 if:

- it is made to a person because they (or another person) are incapacitated for work; and either
  - the payment is made by a friendly society; or
  - the payment is **not** calculated according to loss of earnings.

30. If the payment does not meet these criteria, it will be assessable income.

31. The following diagram sets out the process for determining how an amount paid out under a policy should be treated. Each payment needs to be considered separately. As noted above, where a single payment is made for more than one thing, apportionment may be required:

Treatment of payment made to a person under a policy of personal sickness or accident insurance



Examples

32. The following examples are included to assist in explaining the application of the law.

Example 1: Income Protection Insurance

33. Joan takes out an income protection insurance policy for herself. Joan's employment contract contains a clause that, if Joan takes out an income protection insurance policy, her employer will pay the premiums. Joan's policy provides that, if Joan is unable to work due to sickness or accident, she will be paid 75% of her lost earnings. Joan and her employer want to know the income tax implications of this.

34. Joan's employer is allowed a deduction for the amounts of premium paid to the insurer. There is no PAYE payable on the amount of premiums as they are excluded from being "expenditure on account" under s CE 5(3)(j). If Joan becomes unable to work and her policy pays out, these amounts will be Joan's assessable income. The payments will not be exempt under s CW 34 as they will be calculated according to the earnings that Joan has lost.

Example 2: Accident Insurance

35. Dennis takes out an accident insurance policy and, as part of his remuneration package, his employer agrees to pay the premiums. Under the policy Dennis will receive a fixed lump sum payment on the occurrence of certain specified events if caused by an accident. Dennis' accident insurance policy will also reimburse medical expenses incurred as a result of an accident up to a maximum of $50,000. Dennis' employer is allowed a deduction for the premiums and Dennis is subject to PAYE on the amounts of the premiums paid.

36. The following year Dennis has an accident while using his axe at home and loses a toe. His policy pays out a fixed amount of $1,000 for the loss of his toe and also reimburses Dennis $10,000 for his medical expenses. Dennis wants to know whether to include these amounts in his income.

37. The sum for the loss of his toe and the reimbursements of Dennis' medical expenses are not income. The amounts are not income under ordinary concepts. They are not periodic or regular payments. Also, they are not paid to compensate Dennis for lost income nor are they payments on which Dennis can rely for his living expenses.

References

Related rulings/statements
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11
"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
Subject references
Expenditure on account of an employee, income protection insurance, personal sickness or accident insurance
Legislative references
Income Tax Act 2007 – ss CA 1, CA 2(2), CE 1(1), CE 5, CE 11, CW 34, CX 4, DA 1, DA 2, RD 2, RD 3, RD 5(2) and the definition of "salary or wages" in s YA 1
Case references
FCT v Hyteco Hiring Pty Ltd 92 ATC 4,694
Reid v CIR (1985) 7 NZTC 5,176

QB 15/10: INCOME TAX – INSURANCE – PERSONAL SICKNESS AND ACCIDENT INSURANCE TAKEN OUT BY EMPLOYER FOR THE BENEFIT OF AN EMPLOYEE

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

This Question We've Been Asked is about ss CA 1, CA 2(2), CE 1(1), CE 5, CE 11, CW 34, CX 2, CX 16, CX 31, CX 37, DA 1, DA 2 and GB 32.

1. This Question We've Been Asked (QWBA) considers the income tax treatment of personal sickness or accident insurance policies. Some personal sickness or accident insurance policies include elements of income protection insurance. There are specific provisions in the Act that apply only to income protection insurance, so income protection insurance may have a different tax treatment to other personal sickness or accident insurance.
2. This QWBA does not consider the treatment of payments to or from sickness, accident, or death benefits funds.
3. This QWBA also does not consider the treatment of weekly compensation purchased under s 223 of the Accident Compensation Act 2001.

Question

4. What is the income tax treatment of a personal sickness or accident insurance policy that is taken out by an employer where an employee (or their spouse, civil union partner, de facto partner or child) is the beneficiary?

Answer

5. The employer will generally be entitled to a deduction for the premiums paid.
6. The premiums paid will be subject to FBT unless they are premiums paid for income protection insurance where:
   - the employer has a liability to pay (or contribute to) the premiums; and
   - a pay-out under the insurance policy would be assessable income of the employee.
7. Amounts paid out (or that an employee is otherwise entitled to) under income protection insurance policies will be the employee's income under s CE 11. Amounts paid out (or that an employee is otherwise entitled to) under other personal sickness or accident insurance policies will be income only if they are income under ordinary concepts (s CA 1(2)). Amounts that are not income under ordinary concepts will not be subject to tax.
8. Amounts that are income under s CE 11 or s CA 1(2) will be exempt income if they are payments:
   - made to a person because they (or another person) are incapacitated for work; and either
     – paid by a friendly society (s CW 34(2)(a)); or
     – **not** calculated according to a loss of earnings (s CW 34(2)(c)).
9. If the payment does not meet these criteria, it will be assessable income.
10. This item applies to both individual personal sickness or accident insurance policies and group policies where the employees (or associates) are the beneficiaries of the p olicy.

Explanation

11. Inland Revenue recently undertook a review of all *Public Information Bulletins* (see **http://www.ird.govt.nz/technical-tax/pib-review/**). During that review, two items on the income tax treatment of insurance in an employment context were identified as being out of date. The two items are "Staff insurance schemes" (*Public Information Bulletin* No 70 (December 1972): 11) and "Life and accident insurance policies" (*Public Information Bulletin* No 106 (July 1980): 2). Those PIBs covered a number of different scenarios. We intend to replace the PIBs with a series of Questions We've Been Asked (QWBAs) covering common scenarios.
12. This QWBA considers the situation where a personal sickness or accident insurance policy is taken out by an employer for the benefit of an employee. See QB 15/09 for discussion of situations where the employee takes out the policy and the employer pays the premiums.
13. There are many different types of insurance policies that could be sickness or accident insurance (or could include an element of personal sickness or accident insurance). These include medical insurance, income protection insurance, accident insurance, and trauma or critical illness policies. Pay-outs under these insurance policies can be periodic or lump sum and can be calculated in a variety of ways.
14. Where only part of a policy comes within a particular definition, it may be necessary to apportion premiums between different types of insurance. Similarly where a pay-out under a policy is made for more than one thing, apportionment of the receipt may be required.

Deductibility of premiums for employer

15. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable (and/or excluded) income (s DA 1). Section DA 2 sets out some limitations on deductibility. For example, expenditure that is capital in nature, or expenditure incurred in deriving exempt income, is not deductible (s DA 2(1) and (3)).

16. In most cases, salary and wage costs will be deductible because they will satisfy the nexus test in s DA 1 and none of the general limitations will apply. The payment of a sickness or accident insurance premium for an employee that is paid in connection with the employee's employment is a business cost just like salary or wages. Therefore, provided the costs of an employee's salary or wages are deductible, the costs of paying the insurance premiums will be too.

When amount of premium is subject to FBT

17. Under s CX 2, a "fringe benefit" is a "benefit" that is provided by an employer to an employee in connection with their employment (s CX 2(1)(a)) and comes under s CX 2(1)(b) within either one of ss CX 6, CX 9, CX 10, or CX 12 to CX 16 (specified benefits) or is an unclassified benefit under s CX 37. Some benefits are also excluded from being fringe benefits by specific provisions in subpart CX (see s CX 2(1)(c)).

18. The Commissioner's view is that the provision of an accident or sickness insurance policy where the employee is a beneficiary is a "benefit" to the employee. It provides an economic advantage to the employee as it gives the employee benefits (coverage under the policy) to which they would otherwise not be entitled. Provided the benefit is provided to an employee in connection with their employment, s CX 2(1)(a) is satisfied. It is, therefore, necessary to consider whether the policy is a specified benefit under one of ss CX 6, CX 9, CX 10, or CX 12 to CX 16, or whether an unclassified benefit arises (s CX 37). It is also necessary to consider whether any exclusion could apply.

19. The only potentially relevant specific provision is s CX 16. Section CX 16 applies when an employer pays a "specified insurance premium" or makes a contribution to the insurance fund of a friendly society for the benefit of an employee (s CX 16(1)). The potentially relevant definition of "specified insurance premium" is set out in s CX 16(6):

> **CX 16 Contributions to life or health insurance**
>
> ...
>
> *Health insurance*
>
> (6) The third kind of policy referred to in subsection (3) is a policy of insurance under which the benefits are payable only for—
>
> (a) an accident, whether fatal or not, to the employee, their spouse, civil union partner or de facto partner, or their child; or
>
> (b) disease or sickness of the employee, their spouse, civil union partner or de facto partner, or their child.

20. A sickness or accident insurance policy will come within s CX 16 where the only benefits payable under the policy are for accident, disease or sickness. If a sickness or accident insurance policy fits within s CX 16(6), then s CX 2(1)(b) will be satisfied.

21. If a sickness or accident insurance policy does not come within s CX 16, it will be an unclassified benefit under s CX 37 (as long as there is no specific provision in subpart CX excluding it). Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not covered and are not excluded by a more specific provision.

22. Where an employer provides a fringe benefit to a person associated with an employee, s GB 32 may treat the benefit as if it were provided by the employer to the employee. This is subject to the shareholder-employee exemption in s GB 32(2) and the look-through company exemption in s GB 32(2B). Therefore, premiums paid on policies of personal sickness and accident insurance taken out by an employer for the benefit of an employee's spouse, civil union partner, de facto partner or child will also be subject to FBT.

Exclusion from FBT

23. The only potentially relevant exclusion is s CX 31. Section CX 31 provides:

> An employer who satisfies a liability to pay, or contribute to the payment of, a premium for income protection insurance for the benefit of an employee does not provide a fringe benefit to the employee if a payment of the insurance to the employee would be assessable income of the employee.

24. Section CX 31 will exclude from FBT such income protection insurance:

- provided by an employer;
- for the benefit of an employee;
- where the employer satisfies a liability to pay (or contribute to) the premiums; and

- a pay-out under the insurance policy would be assessable income of the employee (this requirement is considered below).

25. Where a personal sickness or accident policy is also (or also includes) income protection insurance and all of the above requirements are met, the provision of the income protection insurance will not be a fringe benefit. In all other cases, FBT will apply.

Treatment of proceeds to the employee

26. Whether a payment made under an insurance policy is taxable will depend on what it is paid for. Some payments will not be income (under a specific provision or ordinary concepts) and, therefore, will not be taxable. Payments that are "income" may be either assessable or exempt income depending on the circumstances. The following discussion is intended to assist with determining how a payment under an insurance policy should be treated.

Is the payment to the employee income?

27. If a personal sickness or accident insurance policy is (or includes) income protection insurance, s CE 11 may apply. Payments made under a policy of income protection insurance where an employer is liable to pay or contribute to the premiums are income to the employee under s CE 11.

28. There are no specific provisions that apply to make payments under other personal sickness or accident insurance policies income. Therefore, payments under these policies will be income only if they are income under ordinary concepts (s CA 1(2)).

29. Whether a payment under an insurance policy is income or not will depend on the relationship between the payer and the recipient and the purpose of the payment (*Reid v CIR* (1985) 7 NZTC 5,176). Where a payment is made to replace income which the recipient would otherwise have earned or where the purpose of the payments is to provide the recipient with amounts to meet their living expenses, the payments are likely to be income. Payments that are regular or recurring are much more likely to be income (Reid). However, a one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).

30. Therefore, the payments that are most likely to be income are payments that are intended to compensate an insured person for lost income (whether periodic, or lump sum) and other regular or periodic payments intended to help the insured person meet their living expenses. Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made for the loss of a limb, or a payment reimbursing medical expenses).

31. Payments that are not "income" (either under s CE 11 or s CA 1(2)) will not be taxable. If a payment is "income", it is necessary to consider whether it is assessable income or exempt income.

Is the payment exempt income of the employee?

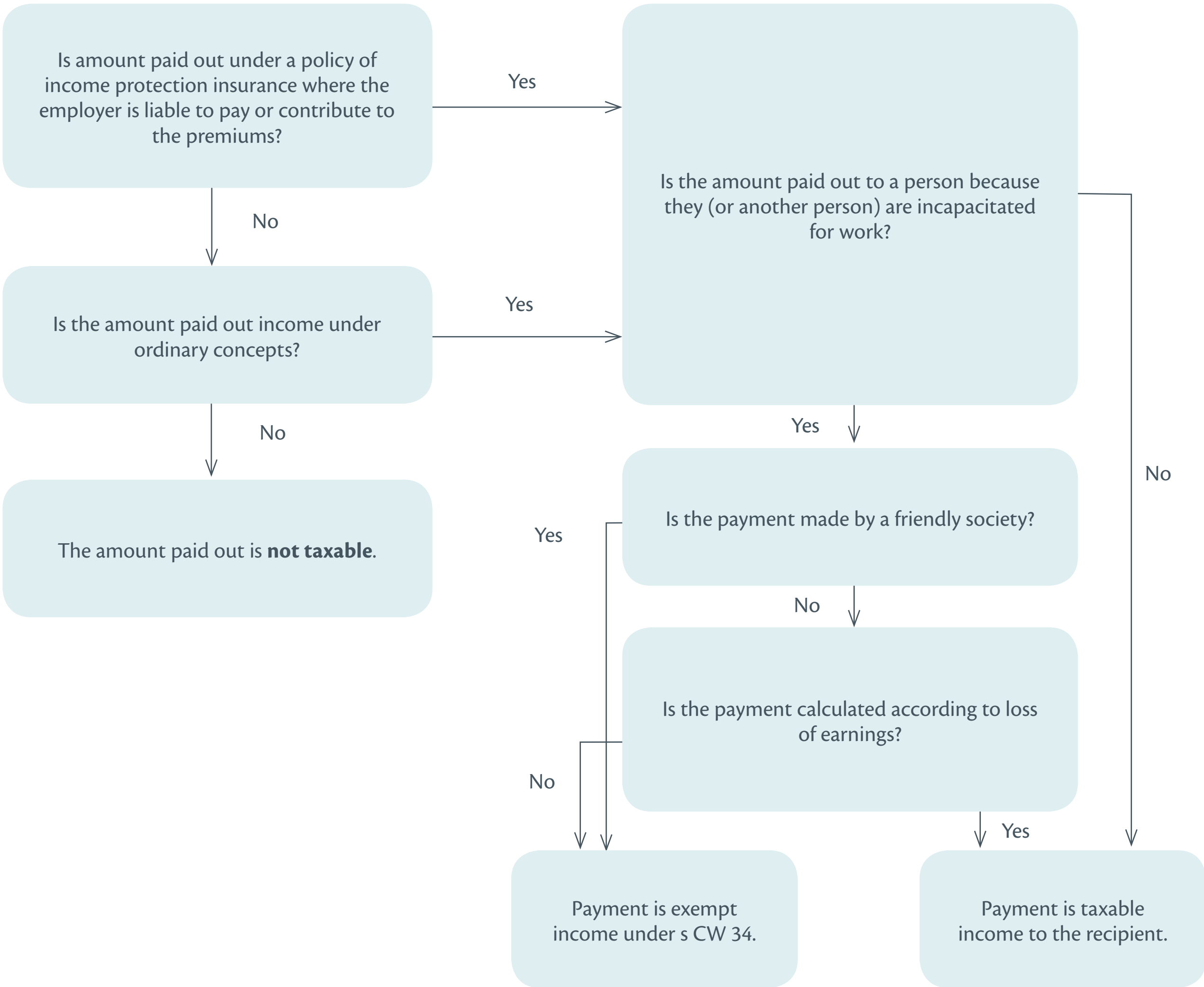
32. The relevant exemption provision is s CW 34. A payment of income made under a policy of personal sickness or accident insurance will be exempt under s CW 34 if:

- It is made to a person because they (or another person) are incapacitated for work; and either:
  - the payment is made by a friendly society; or
  - the payment is **not** calculated according to a loss of earnings.

33. If the payment does not meet these criteria, it will be assessable income.

34. The following diagram sets out the process for determining how an amount paid out under a policy should be treated. Each payment needs to be considered separately. As noted above, where a single payment is made for more than one thing, apportionment may be required:

Treatment of payment made to a person under a policy of personal sickness or accident insurance



Example

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

36. Keith's employer takes out medical insurance policies for each of its senior staff. The policies pay out various amounts if the insured person contracts a disease or becomes sick. Keith's employer is allowed a deduction for the premiums. The premiums are subject to FBT because a fringe benefit arises under s CX 16(6).

37. Keith contracts influenza and is hospitalised. Keith receives a $10,000 payment as a reimbursement of his hospital expenses. Keith wants to know whether to include the $10,000 in his income.

38. The $10,000 is not income. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Keith for lost income.

References

Related rulings/statements
"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11
Subject references
Expenditure on account of an employee, FBT, fringe benefit, income protection insurance, life insurance, personal sickness or accident insurance
Legislative references
Income Tax Act 2007 – ss CA 1, CE 1(1), CE 5, CE 11, CX 2, CX 16, CX 31, CX 37, DA 1, DA 2, GB 32, RD 3, RD 5(2) and the definitions of "expenditure on account of an employee" and "salary or wages" in s YA 1
Case references
FCT v Hyteco Hiring Pty Ltd 92 ATC 4,694
Reid v CIR (1985) 7 NZTC 5,176

QB 15/11: INCOME TAX – SCENARIOS ON TAX AVOIDANCE – 2015

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

This Question We've Been Asked is about s BG 1.

Introduction

1. At a tax conference in 2014, a panel discussed whether s BG 1 would apply to certain scenarios. Inland Revenue was invited to provide comment on the scenarios and did so as part of that panel discussion. Given that discussion, and the view that the scenarios would be of interest to a wider audience, the scenarios have been used as the basis of this Question We've Been Asked (QWBA). This QWBA follows the publication of two QWBAs concerning s BG 1 and different scenarios discussed at an earlier tax conference in 2013: QB 14/11: "Income tax – scenarios on tax avoidance" *Tax Information Bulletin* Vol 26, No 11 (December 2014): 3 and QB 15/01: "Income tax – tax avoidance and debt capitalisation" *Tax Information Bulletin* Vol 27, No 3 (April 2015): 25.

2. The Commissioner's view as to whether s BG 1 applies in these scenarios must be understood in the following terms. First, the conclusions reached are limited to the arrangements set out below. Additional relevant facts or variations to the stated facts might materially affect how the arrangements operate and different outcomes under s BG 1 could arise. Next, as the objective is to consider the application of s BG 1, the analysis proceeds on the basis that the tax effects under the specific provisions of the Act are achieved as stated. Finally, the implications of any relevant specific anti-avoidance provisions are not considered.

3. Section BG 1 is only considered after determining whether other provisions of the Act apply or do not apply. Where it applies, s BG 1 voids a tax avoidance arrangement. Voiding an arrangement may or may not appropriately counteract the tax advantages arising under the arrangement. If it does not appropriately counteract the tax advantages, the Commissioner is required to apply s GA 1 to ensure this outcome is achieved.

4. The explanations in this QWBA apply the approach to s BG 1 set out in the Commissioner's Interpretation Statement IS 13/01: "Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007" *Tax Information Bulletin* Vol 25, No 7 (August 2013): 4.

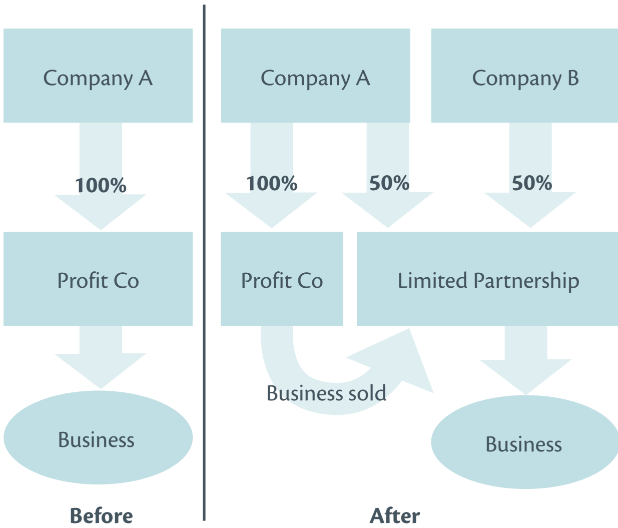
SCENARIO 1 – USE OF A LIMITED PARTNERSHIP

Arrangement

5. This scenario concerns an arrangement involving three New Zealand resident companies:
   - Company A, a tax loss company;
   - Profit Co, a wholly-owned subsidiary company of Company A that is operating a profitable business; and
   - Company B, a company that is unassociated with Company A and Profit Co.

6. The arrangement:
   - Companies A and B establish a limited partnership (LP), registered under the Limited Partnerships Act 2008.
   - Companies A and B make equal contributions to the capital of the partnership and agree to each receive a 50% share of partnership profits and losses.
   - Profit Co sells its business operations to the LP at the open market value of those operations.

7. The following diagram shows the situation before and after the arrangement:



Question

8. Does s BG 1 apply to this arrangement?

Answer

9. No. The Commissioner's view is that, without more, s BG 1 **would not apply** to this arrangement.

Explanation

The arrangement's objectives and tax effects

10. The objective of the arrangement is for Company B to take a financial interest in the business of Profit Co.

11. The tax effects of the arrangement are:
    - Profit Co no longer derives business income.
    - The LP derives business income.
    - The LP is transparent for tax purposes with Companies A and B each deriving 50% of the LP's income.
    - Company A can offset its share of LP income against its tax losses.
    - Company A's ability to group tax losses with Profit Co under subpart IC is unaffected.
12. These tax effects arise under the following specific provisions:
    - s CB 1 (Amounts derived from business)
    - core provisions: s BC 4 (Net income and net loss); s BC 5 (Taxable income)
    - subpart IA (General rules for tax losses)
    - subpart IC (Grouping tax losses)
    - subpart HG (Joint venturers, partners, and partnerships).
13. There may also be tax effects arising from the sale of the business (eg, depreciation recovered), although these are not of significance to the subsequent s BG 1 analysis.

Parliament's purposes for the provisions at issue

Business income

14. Parliament intends that amounts a person derives from a business are treated as income and taxed. This is made clear by Parliament explicitly legislating s CB 1 to ensure this is the case. As stated by Richardson J of a predecessor of s CB 1 in *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 (CA), "[a] gain made in the ordinary course of carrying on the business is thus stamped with an income character" (at 11,391).

Losses

15. Parliament contemplates taxpayers incurring losses where their annual total deduction is more than their annual gross income (s BC 4(3)). It contemplates the net loss is dealt with in certain ways. A net loss is dealt with under Part I (Treatment of tax losses) and it may be offset from future income, made available to another person or dealt with in certain other ways (s BC 4(4)). A person's taxable income for a tax year is determined after subtracting any available tax losses under Part I (s BC 5).
16. Generally, Part I provides that a person's tax loss for a tax year is the sum of their loss balance brought forward, current year net loss and certain other amounts (eg, unused imputation credits) (s IA 2). Any tax losses not able to be offset against current income can be carried forward to subsequent income years and offset (s IA 4).
17. However, Parliament has also provided specific restrictions for companies (s IA 5). These restrictions require a minimum of 49% continuity of voting interests to be held by the same group of people from when the losses are incurred to when they are ultimately offset against income. That is, within some limits, Parliament generally expects the same group of people with a financial interest in the company when the losses are incurred get to enjoy the benefit of those losses being offset against income in the future.
18. Similarly, where a tax loss is to be made available to another person and the parties are companies, Parliament expects a 66% commonality of shareholding to exist between the profit and loss companies from the start of the period when the loss was incurred to the end of the year of offset (subpart IC).

Limited partnerships

19. The primary objective of the limited partnership rules is to facilitate sustainable growth in New Zealand's investment capital sectors, such as venture capital, by providing a legal and tax structure recognised and accepted by investors (see "New legislation – Taxation (Limited Partnerships) Act 2008" *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): 4).
20. A limited partnership under the Act means a limited partnership registered under the Limited Partnerships Act 2008. It includes an overseas limited partnership, but does not include a "listed limited partnership" or a "foreign corporate limited partnership" (s YA 1 definition of "limited partnership").
21. Generally, limited partnerships are treated as transparent for tax purposes (s HG 2). For the purposes of calculating partners' obligations and liabilities, the partners are treated as carrying on the partnership's activities and having the status, intention and purpose of the partnership (s HG 2(1)). Any income, expenses, tax credits, rebates, gains and losses arising for the partnership flow through to the partners in proportion to their interest in the partnership (s HG 2(2)). There are rules concerning the entry and exit of partners (ss HG 3 to HG 10). There are also rules placed on limited partners that ensure the partners' tax losses are restricted if the amount of the loss exceeds the tax book value of their investment (s HG 11).

Facts, features and attributes

22. To give effect to its purposes for these provisions, Parliament would expect to see the following facts, features or attributes, as matters of commercial and economic reality:

- The formation of a partnership relationship between Companies A and B.
- The registration of the partnership as a limited partnership under the Limited Partnerships Act 2008.
- Companies A and B contributing equally to the capital of the LP as agreed between them.
- The disposal of Profit Co's business to the LP, with the consequences that Profit Co no longer conducts the business and ceases to derive business income.
- The LP acquiring the business of Profit Co at its open market value, with the consequences that the LP conducts the business and commences deriving business income.
- Companies A and B sharing equally in the profits or losses of the LP, returning these as income or losses in their respective tax returns each year the arrangement remains operative.
- A minimum of 49% continuity of shareholding in the group of persons holding voting interests in Company A from the beginning of the year in which the company's tax losses were incurred until the end of any year in which they are offset against LP income.
- A minimum of 66% commonality of shareholding between the group of persons holding voting interests in Company A and Profit Co from the time Company A incurred the tax losses until the end of any year in which they are offset against any future income of Profit Co.

The commercial reality and economic effects of the arrangement

23. The next step is to consider the commercial reality and economic effects of the arrangement. This is undertaken to determine whether the required facts, features and attributes are present in the arrangement. If so, Parliament's purposes for the relevant provisions are being upheld.

24. The commercial and economic reality of the current arrangement is that:

- Companies A and B contribute equally to the formation of a registered limited partnership from which they return equal shares of income and losses for tax purposes.
- There is an arm's-length sale of Profit Co's business to the LP.
- The LP, and not Profit Co, conducts the business and derives business income.
- There is no change in the composition of the group of persons holding voting interests in Company A or Profit Co.

Applying the Parliamentary contemplation test

25. In the Commissioner's opinion, the commercial and economic reality of the arrangement accords with its legal form. There are real economic consequences to the parties that reflect that form and there are no indications of artificiality or contrivance or other factors that might suggest this was not the case. In reality, a limited partnership has been formed through which a third-party investor, Company B, has contributed capital to take an interest in an actual and existing profitable business. The nature and extent of the financial consequences for the parties is consistent with this arm's-length investment by Company B. Accordingly, Company B's investment through a limited partnership is consistent with Parliament's purposes that limited partnerships are used as investment vehicles.

26. For its part, Company A divests itself of half of its interests in the business and suffers the economic burden of no longer having full access to the profits of the business. It does, however, continue to have the ability to offset losses against half of those profits when those profits are received in the form of LP income. This is because there has been no change in shareholding in Company A that could have meant the company was not able to offset its losses against its share of the LP income or any future income of Profit Co. Therefore, the arrangement does not defeat Parliament's general expectation that the group of people with a financial interest in a company when losses are incurred should also enjoy the benefit of those losses being offset against income in the future.

27. In short, all of the facts, features or attributes Parliament would expect to see present in an arrangement to give effect to its purposes for the specific provisions are present in the current arrangement. Also, there are no facts, features or attributes present in, or absent from, the arrangement that are inconsistent with those expectations.

28. It may be thought that the step of selling the business to the LP was included in the arrangement for tax reasons. That is, to invest in the business activity of Profit Co, Company B could have bought shares in that

QUESTIONS WE'VE BEEN ASKED

company. Had this been the arrangement instead, one of the tax effects of this alternative arrangement would have been to breach the loss grouping provisions of the Act. Company A would then have been unable to offset its losses against any of the profits generated by the business activity.

29. However, applying the Parliamentary contemplation test requires determining the commercial and economic reality of the arrangement actually entered into. It does not involve identifying an arrangement, or one of several arrangements, that is economically equivalent to the arrangement entered into. The latter approach is sometimes referred to as using economic equivalence. It is not the correct approach for determining the economic and commercial reality of an arrangement (see the Commissioner's comments in IS 13/01 at [377]).

30. In addition, the Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115 (at [111]) considered that taxpayers have the freedom to structure transactions to their best tax advantage. They cannot, however, do so in a way that is proscribed by the general anti-avoidance provision. That is, provided taxpayers make use of the provisions of the Act in a way intended by Parliament, they have freedom to choose how they structure their arrangements (see also *Penny v CIR* [2011] NZSC 95 at [49]). Accordingly, there is no general requirement for the parties in this scenario to adopt an alternative, less tax-favourable, arrangement.

31. As determined above, the arrangement in this scenario is not considered to contravene Parliament's purposes for the specific provisions in question.

Conclusion on tax avoidance

32. In the Commissioner's opinion, without more, the factual situation in this scenario is not one to which s BG 1 would apply. That is, the arrangement does not have a tax avoidance purpose or effect.

SCENARIO 2 – INTEREST DEDUCTIONS AND USE OF A PORTFOLIO INVESTMENT ENTITY

Arrangement

33. This scenario concerns the following arrangement:
    - An individual taxpayer, with income that places them on the top marginal tax rate of 33%, borrows funds for a fixed term of 2 years from Bank A and incurs interest at a fixed rate of 5% per annum.
    - Under the conditions of the loan, the taxpayer must apply the borrowed funds to acquire an investor interest in a multi-rate portfolio investment entity (PIE) sponsored by Bank A with any PIE income retained by the bank in satisfaction of the taxpayer's interest obligations under the loan.
    - Bank A's lending is secured over the taxpayer's investor interest in the PIE.
    - The taxpayer notifies the PIE to apply an investor rate of 28%.
    - Under its investment policy, the multi-rate PIE must invest all funds in New Zealand dollar interest-bearing 2-year deposits with Bank A. It derives a fixed pre-tax return of 4.9% per annum.
    - In their annual tax return, the taxpayer deducts the interest expense incurred on the borrowed funds (as calculated under the financial arrangements rules) against their other income.

34. The interest rates and their margin in this arrangement are those provided to the Commissioner at the tax conference. Other facts implicit in the scenario presented at the conference concerning the rates being fixed, the duration of the arrangement and the terms of the loan have been explicitly added.

35. The Commissioner understands that the arrangement as presented may not be realistic or reflect what might occur in practice. Despite this, the arrangement does provide an opportunity to examine how s BG 1 may apply in this context.

Question

36. Does s BG 1 apply to this arrangement?

Answer

37. Yes. The Commissioner's view is that s BG 1 **would apply** to this arrangement.

Explanation

The arrangement's objectives and tax effects

38. The objective of the arrangement is to provide the taxpayer with investment income.

39. The tax effects of the arrangement for the taxpayer are that they:
    - derive excluded income from the PIE, on which a final tax has been levied at their notified investor rate of 28%, and
    - obtain a deduction for interest expenditure, which is offset against income taxed at a marginal tax rate of 33%.

40. The relevant provisions of the Act are the PIE rules in subpart HM, ss CP 1 and CX 56 and the provisions governing the deductibility of interest (ie, the general permission in s DA 1 and s DB 6).

Parliament's purpose for the provisions at issue

The PIE rules

41. A PIE is an entity that makes investments on behalf of one or more investors where the entity has chosen to become a PIE (ss HM 2(1) and HM 71). An aim of the rules is for PIEs to be taxed on collective investment income on a similar basis to individual investors. For instance, PIEs are not taxed on realised gains on shares in New Zealand resident companies, similar to the treatment of most individual investors (s CX 55).

42. Upon becoming a PIE, entities must choose to become a particular type of PIE (s HM 2(2)). The PIE featured in the arrangement has chosen to become a "multi-rate PIE". A multi-rate PIE is liable for tax on the proceeds of investments attributed to natural person investors calculated at different tax rates, being those rates applicable for each investor (s HM 6(1)). In this way, a multi-rate PIE's total tax liability is intended to resemble the total tax liability the group of investors would have had if the investors had made the investments separately.

43. It is also intended that investors receive an after-tax economic return that they would receive if they personally made similar investments to those made by the PIE (s HM 6(2)). However, Parliament also contemplates that some investors could pay less tax if they invested through a PIE than if they invested personally because the maximum prescribed investor rate (PIR) for a natural person investor is 28%, which is less than the top personal tax rate. Therefore, investors' returns may only resemble what they would receive if investing personally.

44. Generally, natural person investors in multi-rate PIEs have no further tax liability on income for which the PIE has a tax liability (s HM 6(1)). This is provided the investor has notified the PIE of the correct rate at which tax is to be paid on their investment proceeds (the PIR). The rate is usually based on the investor's income in previous years (s HM 56, sch 6). The investor's income attributed from a multi-rate PIE is excluded income of the investor (ss CP 1 and CX 56). Excluded income is not included in the investor's assessable income (s BD 1). In most cases, this means that the tax paid by the PIE at the investor's PIR is a final tax on the PIE income.

45. One of the purposes of the rules was to remove inconsistencies between the tax treatment of investments made personally by investors and those made as part of a collective investment vehicle that disadvantaged the latter. It was considered important that investors' decisions were not distorted by different tax treatments for income from investments that were similar in nature.

46. Also, the timing of the introduction of the PIE rules was linked to the introduction of the KiwiSaver scheme and Parliament's wider purposes of encouraging a long-term retirement savings habit amongst New Zealanders. These measures were expected to result in a rise in taxpayer participation in collective investment vehicles (see *Taxation of investment income* (a Government discussion document, Policy Advice Division of Inland Revenue, June 2005) at [1.13] and the First Reading of the KiwiSaver Bill, Hon Dr Michael Cullen, Minister of Finance (2 March 2006) 626 NZPD 1673).

Interest deductibility

47. The purpose of the Act is to impose tax on net income (s AA 1), which is the amount remaining after deducting from income all deductions allowed under the Act (s BC 4). Generally, deductions are available because Parliament is concerned with taxing a gain, being the balance of proceeds over the costs of generating income.

48. Accordingly, a taxpayer is allowed a deduction for interest expenditure provided it is incurred in deriving their assessable or excluded income or in the course of carrying on a business for the purpose of deriving assessable or excluded income (s DA 1). Deductions for interest are not precluded merely because the interest might be regarded as being of a capital nature (s DB 6). By allowing interest deductions, Parliament clearly contemplates borrowed capital being applied to a purpose that has a connection or nexus with an income-earning activity. In allowing losses to be carried forward, Parliament also contemplates that a return will not always arise from a taxpayer's activities in a particular income year and that in some cases deductions, such as for interest expenditure, will exceed income.

Facts, features and attributes

49. To give effect to its purposes for these provisions, Parliament would expect to see the following facts, features or attributes, as matters of commercial and economic reality:
    - An entity acting as a collective investment vehicle for one or more investors.
    - The entity has chosen to become a PIE and meets all the requirements of being a multi-rate PIE under the Act.
    - Income earned by the PIE is attributed to investors based on their investor interests, on which tax is

paid by the PIE at the investors' notified investor rates.

- The PIE's tax liability resembles the total tax liability the group of investors would have if the investors were to make the investments separately.
- The investors' after-tax economic return from their interest in the PIE resembles the return that would arise if the investors had invested personally in similar investments to those made by the PIE.
- Borrowed funds on which interest accrues have been applied in connection with an income-earning activity.
- The PIE is part of the investors' savings and investment activities.

The commercial reality and economic effects of the arrangement

50. The next step is to consider the commercial reality and economic effects of the current arrangement. This is undertaken to determine whether the required facts, features and attributes are present in the arrangement. If so, Parliament's purposes for the relevant provisions are being upheld.

51. It is accepted that in this arrangement there exists, as matters of commercial and economic reality, the following facts, features and attributes:
    - An entity is acting as a collective investment vehicle for one or more investors, including the taxpayer.
    - The entity has chosen to be a multi-rate PIE and meets all the requirements of being a multi-rate PIE under the Act.
    - Income earned by the PIE is attributed to the taxpayer based on their investor interest and on which tax is paid by the PIE at the taxpayer's notified investor rate.
    - The PIE's tax liability resembles the total tax liability the group of investors would have if the investors were to make the investments separately.
    - The taxpayer's after-tax economic return from the interest in the PIE resembles the return that would arise if they had invested personally in similar investments to those made by the PIE.

52. However, Parliament would also expect to see present, as matters of commercial and economic reality, the following facts, features and attributes:
    - The borrowed funds on which the interest accrued and claimed by the taxpayer as a deduction have been applied in connection with an income-earning activity.
    - The PIE is part of the taxpayer's savings and investment activities.

53. Ascertaining whether these facts, features or attributes are present as matters of commercial and economic reality must take into account the whole of the arrangement. Viewed as a whole, the arrangement involves circular movements of funds. Amounts lent by the bank to the investor must be re-invested with the bank via the PIE. Similarly, interest income paid by the bank must be applied in satisfaction of the investor's interest obligation to the bank. The circular movement of money in an arrangement is often an indicator of tax avoidance, as it can lead to the effective neutralisation or distortion of economic outcomes. This, in turn, may mean that the expected facts, features or attributes are not, in reality, present.

54. The economic consequences that arise as a result of the circularity in the present arrangement are that the taxpayer's interest income on the PIE investment is wholly applied in satisfaction of their interest obligation to the bank, with the remainder being funded by the tax system (see para 56 below). In reality, borrowing usually requires undertaking risk. The commercial and economic reality of the current arrangement, however, is that the usual risks associated with borrowing are absent. Also, the circular nature of the arrangement means that typical commercial constraints do not apply and the arrangement could be scaled-up to any level of borrowing and investing.

55. The result is that the financial consequences of the arrangement are neutralised or distorted and unlike those expected of an arrangement involving borrowing and investing. It follows that, as a matter of commercial and economic reality, there is no real borrowing or application of funds to an income-earning activity. It also follows that, as a matter of commercial and economic reality, the involvement of the PIE is not part of the taxpayer's savings and investment activities.

56. Furthermore, as mentioned, the taxpayer's interest obligations under the loan not satisfied by the PIE income are funded by the tax system. This is the result of the arrangement as a whole being pre-tax negative and post-tax positive. That is, the arrangement makes a gross loss of 0.1% because the interest rate on the loan of 5.0% is greater than the PIE income of 4.9%. In comparison, the arrangement is post-tax positive and produces a net return of 0.178%. This is because the PIE income is subject to tax at 28% with the interest expense able to be offset against non-PIE income that would have been subject to tax at the higher rate of

33%[1]. This aspect of the arrangement means that, even if it is accepted that the arrangement involves borrowing and investing as matters of commercial and economic reality (which it is not), any net investment return arises from the tax system and not the investment itself. This also leads to a conclusion that there is no real savings or investment activity as contemplated by Parliament.

57. While the fact that an arrangement may be pre-tax negative and post-tax positive is not decisive of itself, it is relevant here as this aspect of the arrangement is fixed for the duration of the arrangement. This is because of the fixed nature of the terms and interest rates applying to the borrowing and to the PIE investment. It is also because the nature of the PIE's investment in fixed interest deposits precludes any other economic gains arising from the arrangement. This can be contrasted with other arrangements where either the pre-tax negative investment return is the result of unforeseen events or there is the prospect of other economic gains arising.

58. In summary, there is on the face of it, borrowing with a connection with an income-earning activity of savings and investment. In commercial and economic reality, however, there is no real borrowing or application of funds to an income-earning activity. It follows there can, in reality, be no savings and investment activity. The pre-tax negative, post-tax positive aspect of the arrangement also leads to this latter conclusion.

Applying the Parliamentary contemplation test

59. Applying the Parliamentary contemplation test requires reaching a view on whether the arrangement, when viewed in a commercially and economically realistic way, makes use of the Act in a manner that is consistent with Parliament's purpose. This is done in light of the relevant Parliamentary purposes and the facts, features and attributes that have been identified.

60. The Commissioner accepts that Parliament contemplated taxpayers investing through a PIE to secure the tax advantage of the maximum PIR of 28%. For instance, the current arrangement can be contrasted with a situation where a taxpayer on the highest marginal tax rate withdrew existing investment funds from a non-PIE investment to invest in a PIE (see Example 2, IS 13/01 at 98–101). In that situation the involvement of a PIE is still part of the taxpayer's savings and investment activities because there is an actual investment being made. Therefore, arrangements strongly influenced by tax outcomes are not necessarily tax avoidance arrangements subject to s BG 1.

61. When the current arrangement is viewed in a commercially and economically realistic way, it was accepted that certain facts, features and attributes are present (see para 51). However, as the previous discussion shows, key facts, features or attributes that Parliament would expect to be present are absent from the current arrangement. These are the borrowing's connection to an income-earning activity in a real sense and the involvement of the PIE as part of the taxpayer's savings and investment activities.

62. Overall, the arrangement lacks key facts, features and attributes Parliament would expect to see present to give effect to its purposes for the interest deductibility and PIE rules. This means the arrangement is outside Parliament's purposes for those rules and has a tax avoidance purpose or effect.

The merely incidental test

63. Because the arrangement has a tax avoidance purpose or effect, the next step is to test whether the tax avoidance purpose or effect is merely incidental to a non-tax avoidance purpose or effect. In that case, s BG 1 will not apply even though the arrangement has a tax avoidance purpose or effect. A "merely incidental" tax avoidance purpose or effect is something that follows from, or is necessarily and concomitantly linked to, without contrivance, some other purpose or effect.

64. The purposes or effects of the arrangement could be seen as being concerned with the generation of investment income, which, in turn, relates to the savings and investment activities of the taxpayer. However, this is too general a purpose or effect to explain why the arrangement was structured in the manner it was, particularly using borrowing and a multi-rate PIE. General purposes that can potentially be achieved in several different ways will not explain the particular structure of the arrangement. Consequently, the existence of such a purpose will not be sufficient to establish that a tax avoidance purpose or effect is merely incidental to it.

65. Also, it appears that the only purpose or effect of the arrangement is to generate a return from the tax system, which is a tax avoidance purpose or effect. Therefore the tax avoidance purpose or effect cannot be merely incidental to any other purpose or effect.

[1] The post-tax positive return is calculated as follows: (4.9% × (1 – 0.28)) – (5.0% × (1 – 0.33)) = 0.178%.

Conclusion on tax avoidance

66. Accordingly, the Commissioner considers that the merely incidental test does not prevent the arrangement being considered a tax avoidance arrangement and subject to s BG 1.

Reconstruction

67. Where s BG 1 applies, the arrangement is void as against the Commissioner. The next question to consider is whether this adequately counteracts the tax advantage gained by the taxpayer from the arrangement. If not, the Commissioner must consider using the powers provided by s GA 1 to reconstruct the arrangement to ensure this occurs. The Commissioner has a broad discretion as to how to reconstruct an arrangement and in some scenarios there may be more than one approach possible.

68. In this scenario, voiding the arrangement would mean both the PIE income and interest deductions would be disregarded for tax purposes. However, the tax effects of these two aspects of the arrangement, while creating an overall tax advantage for the taxpayer, are, in practice, spread between the taxpayer and the PIE. This means reconstructing the arrangement may be appropriate provided it restored the arrangement's pre-tax economic outcome, so that it results in a negative return. One straightforward approach to achieving this would be to limit the taxpayer's interest deductions so that the tax benefit arising from them at the 33% marginal tax rate matches the tax already paid by the PIE at the 28% PIR. This approach would adequately counteract the tax advantage by making tax a neutral factor in the arrangement.

SCENARIO 3 – USE OF A DISCRETIONARY TRUST

Arrangement

69. This scenario concerns an arrangement where trustees of a trust pay or vest income in an income year to a single beneficiary and the beneficiary is either:
    - an individual adult beneficiary who is taxed on the beneficiary income at the lowest marginal tax rate, or
    - a corporate beneficiary (that may or may not be solvent) with total tax losses available in that year equal to, or greater than, the beneficiary income, or
    - a corporate beneficiary, where the beneficiary income is a dividend from a foreign company and exempt income of the beneficiary under s CW 9.

70. The only additional facts present are as follows. The trust was validly established and, in undertaking the arrangement, the trustees have fully complied with the terms of the trust deed and with their obligations under general trust law to distribute income to the beneficiaries. The terms of the trust deed do not require the trustees to distribute any or all of the income derived each year. The trustees also have the discretion to choose the beneficiaries or class of beneficiaries that are to receive trust property. All beneficiaries of the trust are existing beneficiaries of the trust and New Zealand tax residents. For tax purposes, the trust is classified as a complying trust under s HC 9. That is, the trust is an ordinary New Zealand domestic trust with New Zealand resident settlors and trustees.

Question

71. Does s BG 1 apply to this arrangement?

Answer

72. No. The Commissioner's view is that, without more, s BG 1 **would not apply** to the arrangement. Variations to the facts that may lead the Commissioner to reach a different view are discussed from para 92.

Explanation

The arrangement's objectives and tax effects

73. The objective of the arrangement is to vest income in, or pay income to a beneficiary taking into account the beneficiary's tax position.

74. The tax effect of the arrangement is that the income derived by the trustees and vested in or paid to the beneficiary is not trustee income and not subject to tax at the trustee tax rate of 33%.

75. Instead, the tax effect is that the income is beneficiary income and:
    - in the case of the individual, is taxed at a rate of tax that is less than the trustee tax rate;
    - in the case of the loss company, is not taxed because of the availability to the beneficiary of sufficient tax losses to offset against the income;
    - in the case of the dividend from a foreign company paid or vested to a corporate beneficiary, is not taxed because the income retains its identity as foreign dividends and is exempt income of the beneficiary under s CW 9.

76. The relevant provisions of the Act are the trust rules in subpart HC relating to beneficiary income and the core provisions in Part B.

Parliament's purposes for the provisions at issue

Beneficiary income

77. Subpart HC provides rules for the taxation of trusts, including the taxation of beneficiary income. Income

derived by a trustee is treated as trustee income and taxed at the rate of 33% unless it is distributed as beneficiary income. Beneficiary income is taxed at the beneficiary's marginal tax rate (s HC 5). An amount derived by a person is income if it is beneficiary income under s HC 6 (s CV 13(a)).

78. Under s HC 6, for income to be distributed as beneficiary income it must be income derived by a trustee that:
    - "vests absolutely in interest" in a beneficiary in the income year, or
    - is "paid" to a beneficiary either in the income year or within a certain period after the end of the income year (ie, within six months of the end of the income year or the earlier of when the trust tax return is filed or is due).

79. Accordingly, beneficiary income can arise in two ways—where it vests absolutely in interest in the beneficiary or where it is paid to the beneficiary (although there is some overlap between the two).

80. Beneficiary income is discussed in the Commissioner's Interpretation Statement IS 12/02: "Income Tax – Whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income" *Tax Information Bulletin* Vol 24, No 7 (August 2012): 49. In summary, the discussion concludes that, in relation to beneficiary income:
    - The phrase "vests absolutely in interest" is a trust law concept and is not defined in the Act.
    - "Vested" means indefeasibly vested, in the sense of finally and absolutely vested, so that the beneficiary obtains an immediate right of present or future possession of the income.
    - The income must exist at the time of vesting. While the amount vested need not be received by the beneficiary until some time in the future, the income must exist rather than be future income or merely an expectancy.
    - The mechanisms by which an amount can vest absolutely in interest in a beneficiary include:
        - a provision of the trust deed that vests the income in the beneficiary, without the need for a trustee resolution;
        - a resolution of the trustees vesting the income in the beneficiary;
        - a payment to, or a credit to an account of, the beneficiary in the income year (or within a certain period after the end of the year).
    - An amount will be "paid" if it is actually paid, distributed, credited or dealt with in the beneficiary's interest or on their behalf. A declaration or resolution by a trustee allocating income to a beneficiary will be sufficient for an amount to be "paid".

81. Accordingly, income need not be physically paid to a beneficiary (such as with a physical transfer of funds to an account) for a beneficiary to derive beneficiary income. It is sufficient for an amount to be credited to a beneficiary, or dealt with in the beneficiary's interest or on their behalf in some other way.

Discretionary trusts and allocating beneficiary income

82. Subpart HC is silent on how trustees of discretionary trusts that are classified as complying trusts should determine who receives beneficiary income or the amount of that income. Parliament has generally left it to general trust law to determine this aspect of trust taxation. However, once trustees make decisions within the constraints of the general trust law, Parliament has indicated its expectations as to the tax consequences that arise. It can be seen that in some areas Parliament has placed practical limitations on the trustees in terms of amounts allocated to beneficiaries. For example, where beneficiary income includes imputation tax credits trustees are effectively prevented by s LE 5 from streaming the credits to one beneficiary. Section LE 5 limits the imputation credit available to a beneficiary by pro-rating the credits over all distributions made to all beneficiaries in the relevant income year. Similarly, in certain circumstances trustees are effectively prevented by s HC 35 from distributing beneficiary income of more than $1,000 in an income year to a beneficiary that is a minor as amounts in excess of that are taxed at the trustee tax rate.

83. Under trust law, where a trust instrument provides trustees with a discretion to choose which beneficiaries should receive trust property, the trustees are entitled to prefer some beneficiaries over others. The House of Lords' decision in *Gartside v IRC* [1968] 1 All ER 121 made it clear the objects of a discretionary trust have no proprietary interest in the trust property or its income. Their rights are restricted to a right to be considered for nomination as a beneficiary by the trustees and a right to compel proper administration of the trust. *Gartside* also confirmed that the trustees of a discretionary trust owe fiduciary duties to discretionary beneficiaries. The beneficiaries have a right that would attract the protection of a court of

equity to ensure the trustees carry out their duties fairly, reasonably or properly. This means trustees of a trust must not exercise their discretion without properly considering all relevant matters as directed by the trust deed and general trust law.

84. Parliament's purposes for trustee and beneficiary income can be found in a combination of general trust law, Part B and subpart HC of the Act. From this, it can be concluded that neither the general trust law nor the Act prevents trustees of a discretionary trust taking into account the tax consequences arising for a beneficiary if they were to receive beneficiary income. These tax consequences arise in the context of the core provisions of the Act from which income tax obligations and entitlements are determined, taking into account such things as tax rates, credits and deductions. Parliament contemplated that tax rates, credits and deductions apply to the income actually derived by the taxpayer. Income derived by a taxpayer could include beneficiary income. In other circumstances, the Act provides for tax losses to arise and for these to be offset against income actually derived by taxpayers. Also, s HC 22 shows that Parliament contemplates that, in some contexts in relation to non-complying trusts, taxpayers deriving beneficiary income may also have tax losses.

Facts, features and attributes

85. Given the above aspects of the trust rules, Parliament would contemplate that the facts, features and attributes present in an arrangement involving beneficiary income would include:
    - A valid trust exists, where the trustees act in accordance with the trust deed and general trust law:
        - The necessary prerequisites to the formation of a trust are met, including the certainty of:
            - an intention to establish a trust,
            - the trust assets being unambiguously defined, and
            - the beneficiaries being able to be ascertained.
        - The trustees are holding and dealing with trust property, including deriving income from the trust property, on behalf of beneficiaries in accordance with the trust deed and general trust law.
    - Income derived by the trustees is paid or vested as beneficiary income to beneficiaries.
    - The beneficiaries receiving distributions of income are eligible to benefit under the trust. That is, they are, in reality, beneficiaries of the trust.
    - The beneficiaries receive the distributions of income. That is, they benefit in some way, either immediately or from future possession of the income so that, in reality, there is a distribution of income to them.
    - The core provisions of the Act, including the rules concerning income, exempt income, basic tax rates and tax losses, apply according to the individual circumstances of the beneficiary.

The commercial reality and economic effects of the arrangement

86. The next step is to consider the commercial reality and economic effects of the arrangement. This is undertaken to determine whether the required facts, features and attributes are present in the arrangement. If so, Parliament's purposes for the relevant provisions are being upheld.

87. In this scenario there is a validly established trust. The distributions of beneficiary income have been undertaken in compliance with the trust deed, general trust law requirements and subpart HC of the Act. The facts, features and attributes Parliament would expect are present as matters of commercial and economic reality. There is no suggestion the beneficiaries are not, in reality, entitled under the trust, or that they will not benefit from the distribution of income to them. Further, on the simple facts of this arrangement, there are no facts, features and attributes present in, or absent from, the arrangement that mean the arrangement is outside Parliament's purposes for the provisions of the Act other than subpart HC.

88. In effect, the commercial and economic reality of the arrangement is the same as its legal form—a distribution of income to beneficiaries as beneficiary income.

Applying the Parliamentary contemplation test

89. The relevant facts, features and attributes contemplated by Parliament to be present in an arrangement involving beneficiary income are present in this arrangement as matters of commercial and economic reality. In these circumstances, the conclusion reached from applying the Parliamentary contemplation test is that the arrangement in this scenario is not a tax avoidance arrangement. This means that s BG 1 would not apply to the scenario.

90. The Commissioner considers this is the correct conclusion despite the clear implication that the trustees' choices in this scenario were significantly influenced by tax considerations. The Supreme Court in *Ben Nevis* considered that taxpayers could structure their arrangements to their best tax advantage, provided the use of the provisions is within what Parliament would have contemplated

(at [111]). Where the use of the provisions is outside what Parliament would have contemplated for them it is appropriate for s BG 1 to apply. Accordingly, arrangements strongly influenced by tax outcomes are not necessarily tax avoidance arrangements subject to s BG 1. Such influences on arrangements would be relevant to whether tax outcomes were merely incidental, but this only becomes important if the arrangement is a tax avoidance arrangement in the first instance. Note that, prior to Ben Nevis, Richardson J recognised this for trusts in *CIR v Challenge Corporation Ltd* [1986] 2 NZLR 513 (CA) at 548–549:

> ... but it was obviously never intended that the use of trusts, which in New Zealand practice in the vast majority of cases is substantially influenced by tax considerations, should be automatically voided under its provisions.

Conclusion on tax avoidance

91. From a commercial and economic reality perspective, the arrangement in this scenario results in the relevant trust provisions and other provisions of the Act applying as Parliament would expect. In those circumstances, it is appropriate that s BG 1 should not apply to the arrangement.

Factual variations

92. While the Commissioner considers s BG 1 does not apply on the simple facts of the arrangement in this scenario, there may be arrangements involving distributions of beneficiary income where the Commissioner may reach a different conclusion.

Factual variations in relation to Parliament's purposes for the trust rules

93. Different facts may call into question whether Parliament's purposes for the trust rules are being given effect. As mentioned above, the facts, features and attributes that need to be present to give effect to Parliament's purposes for the taxation of beneficiary income include the existence of a beneficiary of the trust and of a distribution to that beneficiary. On some facts, it will be arguable that no distribution of income to a beneficiary of the trust was made from a commercial or economic perspective. That is, where it is arguable that, in commercial and economic reality, either:
    - the beneficiary was not a beneficiary of the trust, or
    - no distribution of income was made to the beneficiary.
94. Consideration would need to be given to various facts, including (but not limited to):
    - the timing and pattern of the addition or removal of beneficiaries;
    - how and when the income was distributed (eg, whether authorised distributions are paid in cash or credited to beneficiaries' current accounts);
    - any facts indicating that, in commercial and economic reality, parties other than the trustees or the beneficiaries nominated to receive distributions obtain the use and benefit of the income;
    - any facts indicating that, in commercial and economic reality, there is no realistic prospect of the beneficiaries ever benefiting from the income allocated to them.
95. **On their own there may be nothing inherently wrong with any one of these factors.** For instance, the fact that in any income year the trustees have resolved to pay beneficiary distributions by credit to account and retain the funds for use within the trust would not, on its own, indicate Parliament's purposes for the distribution of beneficiary income were not being given effect. However, in some cases, a combination of the above facts may raise doubts as to whether, in commercial and economic reality, the trustees have made a distribution of income to a beneficiary.
96. Although argued under provisions other than the trust rules, *Krukziener v CIR* (No 3) (2010) 24 NZTC 24,563 (HC) is an example of where, in the context of s BG 1, a court clearly considered that the commercial and economic reality of an arrangement was that the use and benefit of income distributed by trustees was enjoyed by a person other than the beneficiaries nominated to receive the distributions.

Factual variations in relation to Parliament's purposes for other provisions

Another situation where the Commissioner may reach a different conclusion is where an arrangement is contrary to Parliament's purposes for provisions of the Act, other than the trust rules. It is not possible to be specific about such arrangements due to the range of arrangements and other provisions of the Act that could arise. It is likely that, unlike the current scenario, such arrangements would involve additional entities and steps that contribute to the potential for these arrangements to be regarded as tax avoidance arrangements.

Regardless, the same approach to applying s BG 1 outlined above would apply. This approach commences with discerning Parliament's purposes for the relevant provision or provisions of the Act. It then requires determining the facts, features and attributes Parliament would expect to be present (or absent). Finally, the arrangement is examined and a decision is reached on whether the requisite facts, features and attributes are present as matters of commercial and economic reality. If not, the arrangement is likely to be a tax avoidance arrangement unless the tax avoidance purpose or effect is merely incidental to a non-tax avoidance purpose or effect of the arrangement.

References

Subject references
Beneficiary income, interest deductions, limited partnerships, merely incidental, portfolio investment entity, reconstruction, tax avoidance, tax avoidance arrangement, trustee income
Legislative references
Income Tax Act 2007 – ss AA 1, BC 4, BC 5, CB 1, CP 1, CV 13(a), CX 55, CX 56, DA 1, DB 6, BG 1, GA 1, subparts HC, HG, HM, IA and IC, s LE 5, s YA 1 definition "limited partnership"
Case references
AA Finance Ltd v CIR (1994) 16 NZTC 11,383 (CA)
Ben Nevis Forestry Ventures Ltd v CIR [2008] NZSC 115
CIR v Challenge Corporation Ltd [1986] 2 NZLR 513 (CA)
Gartside v IRC [1968] 1 All ER 121 (HL)
Krukziener v CIR (No 3) (2010) 24 NZTC 24,563 (HC)
Penny v CIR [2011] NZSC 95
Related rulings/statements
IS 12/02: "Income Tax – Whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income" *Tax Information Bulletin* Vol 24, No 7 (August 2012): 49
IS 13/01: "Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007" *Tax Information Bulletin* Vol 25, No 7 (August 2013): 4
"New legislation – Taxation (Limited Partnerships) Act 2008" *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): 4
QB 14/11: "Income tax – scenarios on tax avoidance" *Tax Information Bulletin* Vol 26, No 11 (December 2014): 3
QB 15/01: "Income tax – tax avoidance and debt capitalisation" *Tax Information Bulletin* Vol 27, No 3 (April 2015): 25
Other references
Taxation of investment income (a Government discussion document, Policy Advice Division of Inland Revenue, June 2005)
Hon Dr Michael Cullen, Minister of Finance (2 March 2006) 626 NZPD 1673

QB 15/12: DEPRECIATION TREATMENT FOR "BUILDINGS WITH PREFABRICATED STRESSED-SKIN INSULATION PANELS"

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

This Question We've Been Asked provides guidance for both taxpayers and Inland Revenue staff on which buildings the Commissioner considers come within the asset class "Buildings with prefabricated stressed-skin insulation panels" in the "Buildings and Structures" asset category in the Commissioner's Table of Depreciation Rates.

Question

1. What buildings come within the asset class "Buildings with prefabricated stressed-skin insulation panels"?

Answer

2. The asset class "Buildings with prefabricated stressed-skin insulation panels" (also known as "sandwich panels") includes buildings[1] where:
    - the sandwich panels form a core part of the structural framework of the building (meaning that the building is constructed solely of interlocking sandwich panels without a steel frame construction); or
    - the structural framework of the building is steel and:
        - can be categorised as a shade-roof structure (being one where the sheet metal cladding of the warehouse provides shade and weather proofing to the insulation); or
        - the exterior cladding is predominantly made using sandwich panels (ie, no less than 75% of the external cladding).
3. Examples of buildings that potentially fall within this asset class are coolstores, abattoirs or meat processing facilities, and fish processing facilities.

Background

4. The "Buildings with prefabricated stressed-skin insulation panels" asset class appears in the "Building and Structures" asset category in the *Commissioner's Table of Depreciation Rates* ("Depreciation Table") and has a depreciation rate of 4.5% diminishing value (DV) or 3% straight line value, based on an estimated useful life (EUL) of 33.3 years.
5. A prefabricated stressed-skin insulation panel comprises a foam core sandwiched between two "skins". The core is most commonly made from polyurethane or styrene foam and is both durable and light weight. The "skin" is most commonly made from stainless steel, aluminium or plain galvanised steel. These are often referred to as "sandwich panels".
6. There has been some debate on what type of building comes within the asset class. In particular, whether buildings that are only partially built using insulation panels come within the asset class.

Buildings "with" prefabricated stressed-skin insulation panels

7. Under the asset category "Buildings and Structures" in the Depreciation Table is an asset class "Buildings with prefabricated stressed-skin insulation panels".
8. The *Concise Oxford English Dictionary* defines "with" as "accompanied by, in the same direction, or possession; having, or the material used for a purpose"[2]. Therefore, applying the dictionary definition of "with", the building should either be accompanied by prefabricated stressed-skin insulation panels or it must be constructed by means of prefabricated stressed-skin panels.
9. The building asset classes for depreciation purposes are described either by the structural/construction method used or by the activity the structure houses. The asset class "*with* prefabricated stressed-skin insulation panels" is a reference to an element of the construction, rather than to an activity that is being carried on within the structure[3]. Therefore, the Commissioner considers that "with" prefabricated stressed-skin insulation panels refers to a building being constructed "by means of" these panels.

Framing structure and cladding

10. In the asset categories contained in Determination DEP 1: Tax Depreciation Rates General Determination Number 1 (DEP 1), there are two further distinctions in the building asset class descriptions: those that describe the framing structure (for example, buildings *with* steel or timber and steel framing or buildings with reinforced concrete framing), and those that refer to the cladding (for example, shade-houses glass, shade-houses PVC).
11. The Commissioner's view is that the prefabricated stressed-skin insulation panels asset class could include either the building's cladding or the framing structure.

[1] For the meaning of the term "building" in the context of the depreciation provisions, please refer to Interpretation Statement IS 10/02: "Meaning of 'building' in the depreciation provisions" (*Tax Information Bulletin* Vol 22, No 5 (June 2010): 24).

[2] *Concise Oxford English Dictionary*, Oxford University Press 2006.

[3] Other building asset classes refer to activities they house, for example, chemical works, fertiliser buildings, etc.

Buildings made from mixed cladding materials

12. In some instances the exterior cladding of a building may be constructed from mixed materials. For example, a coolstore, where part of the building is made from sandwich panels and part of the building, housing a small administration room, is built from concrete blocks. Alternatively, a building that has steel framing and concrete walls may have a small coolstore facility made of sandwich panels as part of the building.

13. Where the exterior cladding of a building is made from mixed construction materials, the Commissioner will take into account the overall percentage of the different materials used. If, overall, 75% or more of the exterior cladding/external walls of the building is made from sandwich panels, the Commissioner considers that the building comes within the prefabricated stressed-skin insulation building asset class.

Example: Coolstores

14. Since the 1970s, the use of structural sandwich panels has been a cost-efficient construction method for coolstores where hygienic food storage is required.

15. Coolstores operate from 0°C to 10°C and are used to hold product at temperatures in this range. The form that a coolstore takes is determined by the storage regulations, and handling, hygiene and client requirements. The predominant type of coolstore built in New Zealand since the late 1960s has been a single-storey, rectangular shaped building, generally with a maximum storage height of approximately 7.6 metres.[4]

16. Steel is the predominant material used in the framing of coolstore structures due to its economy and resilience in low temperature environments. Typically, a coolstore building was constructed as a weather enclosure and the insulated coolstore created by lining the inside of the warehouse with sandwich panels to form an insulated “box”. These are known as shade-roof structures, where the sheet metal cladding of the warehouse provides a shade and weather roof to the insulation.

17. As manufacturing techniques and sandwich panel quality improved, sandwich panels were increasingly used as unprotected cladding against external weather environments. In these circumstances, the insulated panels were increasingly used as a structural element, weather cladding and insulation.

18. When the Depreciation Table was introduced in 1993, the predominant form of coolstore was the shade roof structure lined with insulation panels. However, as manufacturing techniques have evolved and sandwich panels have improved, the need for sheet metal cladding has been reduced to the extent that the exterior cladding and roof of coolstores are now constructed predominantly of sandwich panels.

Changing a depreciation rate

19. In limited circumstances a taxpayer can change the depreciation rate that they use to depreciate an item of depreciable property. For example, where the taxpayer has been using an incorrect rate.

20. For further guidance on changing to a different depreciation rate please refer to QB 15/03: *Income tax – changing to a different depreciation rate for an item of depreciable property* (*Tax Information Bulletin* Vol 27, No 4 (May 2015): 30).

[4] IPENZ Practice Note 15 – Coldstore Engineering in New Zealand at [4] and [7].

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.

GENERAL DEPRECIATION DETERMINATION DEP96: OIL/GAS EQUIPMENT USED TO EVALUATE, REPAIR OR STIMULATE EXISTING WELLBORES

Note to Determination

The Commissioner has set general depreciation rates for several items of specialised equipment used by oil and gas industry support specialists to evaluate, repair or stimulate the performance of existing wellbores, not currently provided for under the "Oil and Gas Industry" category, within the Commissioner's Table of Depreciation Rates.

The asset class for "Tools, downhole" includes shifting tools, fishing tools, tungsten stembars, pulling tools, gauge rings, broaches and centering tools. The asset class does not include perforating guns which are made by several shaped explosives charges within the gun. As most retrievable perforating guns can be used once only as they distort when fired and are weakened, the Commissioner considers these items are consumable items and be treated as revenue expenditure items.

Mobile steel tanks, usually constructed of welded mild steel to store or distribute water and other liquids, are viewed by the Commissioner to generally have an estimated useful life of 20 years. However, a new asset class of "Mobile storage tanks (mild steel, welded)" has been added to the "Oil and gas industry" category with an estimated useful life of 15.5 years due to harsh environmental conditions. In addition, some tanks are used to hold and distribute corrosive acid or alkali and under those circumstances are viewed to have a shorter life of 10 years, as provided for in this determination.

DETERMINATION DEP96: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 96

1. Application

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

This determination applies from the 2014 and subsequent income years.

2. Determination

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

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

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Tools, downhole (perforating guns excluded; to be treated as consumables, and revenue expense items)	5	40	30
Treating irons	10	20	13.5
Coiled tubing units	12.5	16	10.5
Wireline units	12.5	16	10.5
Slickline units	12.5	16	10.5
Mobile steel tanks (mild steel, welded)	15.5	13	8.5
– If affected by acid or alkali	10	20	13.5
Stuffing boxes and lubricator/riser pipes	10	20	13.5
Slickline floor sheaves	10	20	13.5
Spools	10	20	13.5
Pumping units	10	20	13.5
Nitrogen pumping units	10	20	13.5
Nitrogen generating units	10	20	13.5

3. Interpretation

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

This determination is signed on the 28th day of September 2015.

Rob Wells
LTS Manager, Technical Standards

DETERMINATION CFC 2015/01: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). TOWER Insurance Limited has made application in respect of the CFC set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFC to which this determination applies is:

Name	Jurisdiction
TOWER Insurance (Cook Islands) Limited	Cook Islands

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2015–16 and 2016–17 income years.

This determination is signed by me this 15th day of October 2015.

Maryanne Hansen

Investigations Manager

DETERMINATION CFC 2015/02: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(b) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of the members of a group of CFCs, if the members satisfy subsection (3). TOWER Insurance Limited has made application in respect of the members of the group of CFCs set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFCs to which this determination applies are:

Name	Jurisdiction
Southern Cross Marine Limited	Papua New Guinea
TOWER Insurance (PNG) Limited	Papua New Guinea

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2015–16 and 2016–17 income years.

This determination is signed by me this 15th day of October 2015.

Maryanne Hansen

Investigations Manager

DETERMINATION CFC 2015/03: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(b) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of the members of a group of CFCs, if the members satisfy subsection (3). TOWER Insurance Limited has made application in respect of the members of the group of CFCs set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFCs to which this determination applies are:

Name	Jurisdiction
National Insurance Company (Holdings) Limited	Fiji
TOWER Insurance (Fiji) Limited	Fiji
Southern Pacific Insurance Company (Fiji) Limited	Fiji

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2015–16 and 2016–17 income years.

This determination is signed by me this 15th day of October 2015.

Sharyn Rea

Investigations Manager

DETERMINATION CFC 2015/04: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). TOWER Insurance Limited has made application in respect of the CFC set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFC to which this determination applies is:

Name	Jurisdiction
National Pacific Insurance (Tonga) Limited	Tonga

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2015–16 and 2016–17 income years.

This determination is signed by me this 15th day of October 2015.

Sharyn Rea

Investigations Manager

SPECIAL DETERMINATION S27A: CONVERTIBLE NOTES IN RESPECT OF A LIMITED PARTNERSHIP INTEREST

This determination may be cited as Special Determination S27A: Convertible Notes in respect of a limited partnership interest.

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

1.1 This determination varies and replaces *Special Determination S27: Convertible Notes in respect of a limited partnership interest* following a change of partners in the limited partnership.

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

1.3 Limited Partner C intends to transfer their interest in the Holding Partnership to Limited Partner C1 in late 2015. This determination applies to:

a) Limited Partner A and Limited Partner B from the date of signing;

b) Limited Partner C from the date of signing until the date that they transfer their interest to Limited Partner C1; and

c) Limited Partner C1 from the date that the interest is transferred to them.

1.4 Limited Partner A and Limited Partner C1 have agreed that Limited Partner A will have the option to sell up to 9.9% of the equity interest in the Holding Partnership (along with up to 9.9% of the shareholding in General Partner 1, in equal proportions) to Limited Partner C1. It is envisaged that if the option is exercised it will be exercised after the Convertible Note has converted to committed capital, noting that early exercise rights do exist in limited situations.

1.5 The Convertible Notes will earn a fixed rate of interest that is payable monthly (Coupon Interest Payments) until the Convertible Notes are converted. The Coupon Interest Payments will be capitalised on each interest payment date but will be paid to Limited Partner A on the first partnership distribution date, and therefore will not convert to a partnership interest.

1.6 The conversion to a partnership interest will be effected by way of a mandatory set off. Limited Partner A's obligation to make its capital contribution(s) will be satisfied by setting off that obligation against the Holding Partnership's obligation to repay that portion of the Convertible Notes equal to the capital contribution(s) required to be made on the relevant date.

1.7 The rate of interest will be an arm's length rate determined under an agreed rate setting process.

1.8 No commitment fees or upfront fees are payable on the Convertible Notes.

1.9 In accordance with s EW 6(2) an amount (whether it is income, consideration, gain, loss or expenditure) that is solely attributable to an excepted financial arrangement is not taken into account under the financial arrangement rules.

1.10 As an interest in a partnership is an excepted financial arrangement under s EW 5(11), only the Coupon Interest Payments are regarded as income or expenditure for the purposes of calculating accrual income or expenditure.

1.11 This Determination prescribes a method for determining the part of the consideration receivable by the parties to the arrangement that is solely attributable to the excepted financial arrangement as well as the method for spreading the accrual income, gain or loss, or expenditure under the financial arrangement rules.

2. Reference

This determination is made under ss 90AC(1)(bb) and 90AC(1)(h) of the Tax Administration Act 1994. This determination varies and replaces *Special Determination S27A: Convertible Notes in respect of a limited partnership interest* and applies to:

a) Limited Partner A and Limited Partner B from the date of signing;

b) Limited Partner C from the date of signing until the date that they transfer their interest to Limited Partner C1; and

c) Limited Partner C1 from the date that the interest is transferred to them.

3. Scope of determination

3.1 This determination applies to the Convertible Notes issued by the Holding Partnership to Limited Partner A as part of the Project (which is set out in detail in Private Rulings BR Prv 15/38 and BR Prv 15/39 issued on 8 September 2015). The terms of the Convertible Notes are as follows:

a) Limited Partner A will loan an amount to the Holding Partnership (subject to the prevailing market rates at Financial Close) with repayment being set off against the obligation to make capital contribution(s) in respect of a 45% interest in the Holding Partnership at a single or several nominated dates in the future. The Convertible Notes will have a face value equal to 45% of the total equity requirement (being all of Limited Partner A's 45% interest in the Holding Partnership).

b) The Convertible Notes will earn a fixed rate of interest that is payable monthly until conversion, defined as the construction swap rate exclusive of charges, plus a margin. For Financial Close, the construction swap rate will be calculated based on the prevailing swap rates as determined by standard market methodology.

c) The Coupon Interest Payments will be capitalised on each interest payment date, and paid out to Limited Partner A on the first partnership distribution date, that is, the Coupon Interest Payments will not convert to a partnership interest.

d) The rate of interest will be an arm's length rate determined under an agreed rate set process.

e) No commitment fees or upfront fees are payable on the Convertible Notes.

f) The Convertible Notes (and any interest payable on the Convertible Note) are subordinated to senior debt. After conversion of the Convertible Notes, Limited Partner A will rank equally with Holding Partnership contributions made by the other limited partners.

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

4. Principle

4.1 The Convertible Notes have both debt and partnership interest components. They can be regarded alternatively as:

a) a loan to a partnership with repayment by way of an interest in a partnership (debt component); or

b) a forward purchase of a partnership interest (in which case the holder of the Convertible Notes is buying an interest in the partnership).

The financial arrangement rules in the Act classify an interest in a partnership as an excepted financial arrangement under s EW 5(11).

4.2 As the Convertible Notes have this dual character, when calculating income derived or expenditure incurred in relation to the Convertible Notes it is first necessary to separate the debt and partnership interest components of the Convertible Notes.

4.3 This determination specifies that, apart from the Coupon Interest Payments, all amounts relate to the underlying interest in a partnership, and will not be dealt with under the financial arrangement rules (subpart EW) when calculating income derived or expenditure incurred.

4.4 Income and expenditure in respect of the Convertible Notes is calculated by daily apportionment of the Coupon Interest Payment to income years in accordance with *Determination G1A: Apportionment of Daily Income and Expenditure*.

4.5 For the purposes of this determination it is assumed that any change in the market value of the interest in the partnership between the issue date of the Convertible Notes and the conversion into the partnership interest relates to the partnership interest component and therefore can be ignored when calculating income derived or expenditure incurred under the financial arrangements rules.

5. Interpretation

5.1 In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
- **Coupon Interest Payment** means any amount payable on the Convertible Notes by the Convertible Note issuer (borrower) to the Convertible Note holder (lender) other than payments relating to the redemption or conversion of the Convertible Notes.

- **Financial Close** has the same meaning as set out in the Project Agreement referred to in Private Rulings BR Prv 15/38 and BR Prv 15/39.
- **Limited Partner A** is the holder of the Convertible Notes.
- **The Holding Partnership** is the issuer of the Convertible Notes.
- **Subordinated Convertible Notes** or **Convertible Notes** means the arrangement described in clause 3(1) of this determination.

5.2 For convenience, words and phrases defined in this determination are indicated by initial capital letters, but the absence of a capital letter shall not alone imply that the word or phrase is used with a meaning different from that given by its definition.

6. Method

6.1 Amounts to be included when calculating income or expenditure under the financial arrangements rules with regard to the Convertible Notes in respect of income, gain or loss, or expenditure, and also of any other consideration receivable by the holder or payable by the issuer, consist of the Coupon Interest Payments.

6.2 The income derived or expenditure incurred in respect of the Convertible Notes shall be calculated by daily apportionment of the Coupon Interest Payments to income years. The required method is outlined in *Determination G1A: Apportionment of Daily Income and Expenditure*.

6.3 All other income, gain, loss, expenditure or consideration paid under or with respect to the wider financial arrangement is solely attributable to the excepted financial arrangement component of the wider financial arrangement.

7. Example

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

The example assumes the following:

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

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

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

This Determination is signed by me on the 8th day September 2015.

Howard Davis

Director (Taxpayer Rulings)

SPECIAL DETERMINATION S28A: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO THE D&C PHASE IN A PUBLIC-PRIVATE PARTNERSHIP

This determination may be cited as Special Determination S28A: Application of the financial arrangements rules to the D&C Phase in a public-private partnership.

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

1.1 This determination varies and replaces *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership* following a change of partners in the limited partnership.

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

1.3 Limited Partner A intends to transfer their interest in the Holding Partnership to Limited Partner A1 in late 2015. This determination applies to:

a) Limited Partner A from the date of signing until the date that they transfer their interest;

b) Limited Partner A1 from the date that the interest is transferred to them; and

c) Limited Partner B from the date of signing.

1.4 The Project Agreement comprises three basic components:

a) A design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;

b) A Facility Lease in which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and

c) An operations and maintenance phase (the O&M Phase) under which the Partnership will provide operation and maintenance services to the Crown over a 25 year term in consideration for monthly payments (the Unitary Charge).

1.5 The Partnership has entered into:

a) a Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and

b) an Operation and Maintenance Contract (the O&M Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for monthly payments.

1.6 The Partnership will raise external debt from a range of third party financiers (the Bank Debt). Limited Partner C will provide a term debt facility (the Term Debt Facility) to the Partnership to supplement the Bank Debt.

1.7 The Holding Partnership will receive funding from Limited Partner C during the D&C Phase in the form of a convertible debt instrument (the Convertible Note). Limited Partners A and B will provide investment support during the D&C Phase in the form of a letter of credit to the external lenders.

1.8 The Partnership will enter into Interest Rate Swaps in respect of the Bank Debt.

1.9 The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Bank Debt, Term Debt Facility and Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement.

1.10 *Special Determination S27A: Convertible Note in respect of a limited partnership* applies to the Convertible Notes. *Special Determination S29A: Application of the financial arrangement rules to a public-private partnership* applies to arrangements in the wider financial arrangement, excluding the D&C Payment.

1.11 This determination prescribes the portion of the D&C Payment treated as income under the financial arrangement rules (the Interest Component) and the method for spreading that income.

2. Reference

This determination is made under ss 90AC(1)(bb) and 90AC(1)(i) of the Tax Administration Act 1994. This determination varies and replaces *Special Determination S28: Application of the financial arrangements rules to the D&C Phase in a public-private partnership* and applies to:

a) Limited Partner A from the date of signing until the date that they transfer their interest to Limited Partner A1;

b) Limited Partner A1 from the date that the interest is transferred to them; and

c) Limited Partner B from the date of signing.

3. Scope of determination

3.1 This determination applies to the Partnership in respect of the Project (which is set out in detail in Private Rulings BR Prv 15/38 and BR Prv 15/39 issued on 8 September 2015), including the D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation.

3.2 This determination is made subject to the following conditions:

a) The design and construction costs of the Facility are agreed between the Partnership and the Crown on an arm's length basis and set out in the Base Case under the Project Agreement as referenced to in the definition of "Design and Construction Payment" in section 1.1 of the Project Agreement.

b) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B use IFRSs to prepare financial statements and to report for financial arrangements.

c) The continued application of private rulings BR Prv 15/38 and BR Prv 15/39 issued on 8 September 2015.

d) The executed documentation not being materially different from the final documentation that was provided to Inland Revenue on 23 July 2014 to the extent that it impacts on the scope of the determination or the application of the financial arrangement rules to the Applicants and the scope of the determination.

4. Principle

4.1 During the D&C Phase of the Project Agreement, the Partnership will receive consideration from the Crown (in the form of the D&C Payment) and will in turn provide consideration to the Crown (in the form of the completion of the Project and the transfer of its rights, set out in clause 11.2(c) of the Project Agreement, in the Facility). The D&C Phase of the Project Agreement is a "financial arrangement" under s EW 3 and an "agreement for the sale and purchase of property or services" under s YA 1.

4.2 The Partnership and the Crown have agreed that the D&C Payment includes capitalised interest (clause 12.5(c) of the Project Agreement). The Interest Component of the D&C Payment will be income under the financial arrangements rules under subpart EW.

4.3 During the D&C Phase the Partnership has variable expenditure commitments which will accrue. The capitalised interest component of the D&C Payment is intended to offset the expected funding costs incurred in relation to these commitments.

4.4 The Interest Component is calculated with reference to expected funding costs. No adjustment is made for variances between actual and expected costs as the D&C Payment, including capitalised interest, is agreed in advance.

4.5 The Interest Component needs to be spread over the term of the D&C Phase.

5. Interpretation

In this determination, unless the context otherwise requires:

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

6. Method

Calculation of Interest Component

6.1 The value of the completion of the Project and transfer of the Partnership's rights to the Crown, set out in clause 11.2(c) of the Project Agreement, is the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement.

6.2 The D&C Payment less the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement, is the Interest Component that is income under the financial arrangements rules.

6.3 Private Ruling BR Prv 15/39 rules on the portion to the D&C Payment that is not income under the financial arrangements rules, and is not considered in this determination.

Spreading of Interest Component

6.4 The method for determining the amount of income that is to be allocated to each income year is as follows:

a) The expected design and construction costs of the facility (excluding fitout) as set out in the Base Case are treated as having been incurred at the beginning of each of the six income years (the Annual Expenditure). No adjustment will be made to the Annual Expenditure in any income year to reflect actual expenditure in that year.

b) The interest allocated to each income year is then calculated in accordance with the following formula:

$$\text{Interest} = OB \times R$$

Where:

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

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

7. Example

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

The Partnership and the Crown agree to the D&C Payment under the Base Case sheet that the D&C Payment equals $1,200,000. The Base Case sets out that the agreed design and construction costs of the Project (excluding Fitout) are to be $970,748.

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

The Interest Component of the D&C Payment is $229,252 by implication of the valuation under this determination. The Limited Partners will spread the Interest Component over the term of the D&C Phase of the Project Agreement, as follows.

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

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

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

The Interest Component is therefore spread as follows:

Year	Actual D&C costs	Cumulative	Interest income
1	($190,494)	($190,494)	$9,367
2	($296,488)	($496,348)	$24,406
3	($245,464)	($766,218)	$37,675
4	($173,759)	($977,652)	$48,072
5	($62,168)	($1,087,892)	$53,492
6	($2,376)	($1,149,761)	$56,239
		$1,200,000	
	($970,748)		**$299,252**

This Determination is signed by me on the 8th day of September 2015.

Howard Davis

Director (Taxpayer Rulings)

SPECIAL DETERMINATION S29A: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO A PUBLIC-PRIVATE PARTNERSHIP

This determination may be cited as Special Determination S29A: Application of the financial arrangements rules to a public-private partnership.

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

1.1 This determination varies and replaces *Special Determination S29: Application of the financial arrangements rules to a public-private partnership* following a change of partners in the limited partnership.

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

1.3 Limited Partner A intends to transfer their interest in the Holding Partnership to Limited Partner A1 in late 2015. This determination applies to:

a) Limited Partner A from the date of signing until the date that they transfer their interest;

b) Limited Partner A1 from the date that the interest is transferred to them; and

c) Limited Partner B from the date of signing.

1.4 The Project Agreement comprises three basic components:

a) A design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;

b) A Facility Lease in which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and

c) An operations and maintenance phase (the O&M Phase) under which the Partnership will provide operation and maintenance services to the Crown over a 25 year term in consideration for monthly payments (the Unitary Charge).

1.5 The Partnership has entered into:

a) a Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and

b) an Operation and Maintenance Contract (the O&M Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for monthly payments.

1.6 The Partnership will raise external debt from a range of third party financiers (the Bank Debt). Limited Partner C will provide a term debt facility (the Term Debt Facility) to the Partnership to supplement the Bank Debt.

1.7 The Holding Partnership will receive funding from Limited Partner C during the D&C Phase in the form of a convertible debt instrument (the Convertible Note). Limited Partners A and B will provide investment support during the D&C Phase in the form of a letter of credit to the external lenders.

1.8 The Partnership will enter into Interest Rate Swaps in respect of the Bank Debt.

1.9 The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Bank Debt, Term Debt Facility and Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement.

1.10 *Special Determination S27A: Convertible Note in respect of a limited partnership applies* to the Convertible Notes. *Special Determination S28A: Application of the financial arrangement rules to the D&C Phase in a public-private partnership* applies to arrangements in the wider financial arrangement, excluding the D&C Payment.

1.11 This determination prescribes:

a) The amount of consideration that is solely attributable to the Facility Lease;

b) How the financial arrangements rules apply to the O&M Phase of the Project Agreement, the Construction Agreement and the O&M Contract;

c) The method for spreading the payments made under the Bank Debt, Term Debt Facility and Interest Rate Swaps.

2. Reference

This determination is made under ss 90AC(1)(bb) and 90AC(1)(i) of the Tax Administration Act 1994. This determination varies and replaces *Special Determination S29: Application of the financial arrangements rules to a public-private partnership* and applies to:

a) Limited Partner A from the date of signing until the date that they transfer their interest to Limited Partner A1;

b) Limited Partner A1 from the date that the interest is transferred to them; and

c) Limited Partner B from the date of signing.

3. Scope of determination

3.1 This determination applies to the Partnership in respect of the Project (which is set out in detail in Private Rulings BR Prv 15/38 and BR Prv 15/39 issued on 8 September 2015), including the following arrangements:

a) The D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation (which is the subject of *Special Determination S28A: Application of the financial arrangement rules to the D&C Phase of a public-private partnership*);

b) The O&M Phase of the Project Agreement, under which the Partnership will provide ongoing operation and maintenance services for 25 years to the Crown in consideration for monthly payments;

c) The Facility Lease, under which the Partnership will lease the Facility from the Crown for 25 years and make the Rental Prepayment to the Crown. The Rental Prepayment will be equal to and will offset the D&C Payment;

d) A Construction Agreement with the Contractor, under which the Contractor will design and construct the Facility in consideration for payments under the Construction Agreement;

e) An O&M Contract with the Service Provider, under which the Service Provider will provide the ongoing operation and maintenance (and other) services in consideration for payments under the O&M Contract;

f) Bank Debt, under which the Partnership will borrow an agreed sum from external lenders for a term of 7 years from financial close of the Project (Financial Close). The Bank Debt will be a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date. It is expected that the Bank Debt will be refinanced within 7 years of Financial Close, and every 7 years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this Determination), the Bank Debt (and any subsequent re-financings) will initially be recognised at fair value plus integral fees, and subsequently measured using the amortised cost using the effective interest method (regardless of whether or not hedge accounting is applied), and will not be treated as a hedge of another financial arrangement;

g) Interest Rate Swaps, under which the Partnership will pay a fixed rate of interest to the swap counterparties, and receive a floating rate in return;

h) Term Debt Facility under which the Partnership will borrow an agreed sum from Limited Partner C during the D&C Phase for a market rate of interest that converts to an amortising senior tranche on the Conversion Date. The Term Debt Facility will be recognised under IFRS as a financial liability and initially recorded at fair value plus integral fees. Subsequent measurement will be at amortised cost using the effective interest method;

i) Convertible Note issued by the Holding Partnership to Limited Partner C for the duration of the D&C Phase. On a single or several nominated dates during the D&C Phase, the Convertible Note will convert (by way of mandatory set off) into a partnership interest in Holding Partnership for Limited Partner C (which is the subject of *Special Determination S27A: Convertible Note in respect of a limited partnership interest*).

3.2 This determination is made subject to the following conditions:

a) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B use IFRS to prepare financial statements.

b) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B will recognise income derived from the Crown during the D&C Phase of the Project Agreement and the O&M Phase of the Project Agreement, and will deduct expenditure incurred in relation to the Facility Lease, Construction Agreement and O&M Contract, in each case, under the relevant provisions of the Income Tax Act 2007 (outside of the financial arrangement rules).

c) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B do not use the fair value method for the Bank Debt or Term Debt Facility if the Bank Debt or Term Debt Facility is treated as a hedge of another financial arrangement under IFRS and use for the other financial arrangement a method that is neither the IFRS financial reporting method nor the method required under *Determination G29: Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure*.

d) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B will recognise income and expenditure in respect of the Convertible Note in the manner prescribed by *Special Determination S27A: Convertible Note in respect of a limited partnership* interest.

e) While this determination applies to them, Limited Partner A, Limited Partner A1 and Limited Partner B will recognise income in respect of the D&C Payment in the manner prescribed by *Special Determination S28A: Application of the financial arrangement rules to the D&C Phase in a public-private partnership*.

f) The continued application of Private Rulings BR Prv 15/38 and BR Prv 15/39 issued on 8 September 2015.

g) The executed documentation not being materially different from the final documentation that was provided to Inland Revenue on 23 July 2014 to the extent that it impacts on the scope of the determination or the application of the financial arrangement rules to the Applicants and the scope of the determination.

4. Principle

4.1 The Facility Lease is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(2) to (16) is not an amount that is taken into account under the financial arrangement rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Facility Lease that are not taken into account under the financial arrangement rules.

4.2 The O&M Phase, Construction Agreement and O&M Contract are "short-term agreements for sale and purchase" as defined in s YA 1, and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement, is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Partnership in respect of the O&M Phase, Construction Agreement and O&M Contract are required to be spread under the financial arrangements rules.

4.3 The D&C Phase, Bank Debt, Interest Rate Swaps and Term Debt Facility are "financial arrangements" under s EW 3. This determination specifies that the payments made to or by Limited Partner A, Limited Partner A1 and Limited Partner B, in proportion to their share in the Holding Partnership, under the Bank Debt, Interest Rate Swaps, and Term Debt Facility must be spread under the financial arrangements rules in accordance with this determination.

4.4 This determination does not deal with the treatment of the D&C Payment or the Convertible Note which are subject to separate determinations (*Special Determination S27A: Convertible Note in respect of a limited partnership interest and Special Determination S28A: Application of the financial arrangement rules to the D&C Phase in a public-private partnership*).

5. Interpretation

In this determination, unless the context otherwise requires:

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

6. Method

6.1 The Rental Prepayment paid in respect of the Facility Lease, and the property interest granted to the Partnership under the Facility Lease, are solely attributable to the Facility Lease and are not taken into account under the financial arrangement rules.

6.2 Limited Partner A, Limited Partner A1 and Limited Partner B are not required to spread any amounts under the financial arrangements rules in respect of the:

a) O&M Phase of the Project Agreement;

b) Construction Agreement; and

c) O&M Contract.

6.3 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Bank Debt and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.

6.4 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of any subsequent refinancing of the Bank Debt over the term of the relevant refinancing, provided that the terms of any such refinancing are materially similar to the terms of the Bank Debt. This determination paragraph does not affect Partner A or Partner B's obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.

6.5 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Term Debt Facility. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.

6.6 The expected value method in s EW 15F may be used to allocate income and expenditure (other than "non-contingent fees" as defined in s YA 1) over the term of the Interest Rate Swaps provided that the swaps are not treated as a hedge of other financial arrangements for which the "fair value method" is used. None of the mandatory spreading methods in s EW 15H or s EW 15I apply to the Interest Rate Swaps.

6.7 This determination does not affect Limited Partner A, Limited Partner A1 or Limited Partner B's obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps.

7. Example

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

This example is based on the following parameters:

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

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

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

- Interest on the Bank Debt calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Interest on the Term Debt Facility calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F;
- Amounts in respect of the Convertible Note as specified in *Special Determination S27A: Convertible Note in respect of a limited partnership interest*;
- Amounts in respect of the D&C Payment as specified in *Special Determination S29A: Application of the financial arrangement rules to the D&C Phase in a public-private partnership*.

This Determination is signed by me on the 8th day of September 2015.

Howard Davis

Director (Taxpayer Rulings)

SPECIAL DETERMINATION S41: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO A PUBLIC-PRIVATE PARTNERSHIP AGREEMENT

This Determination may be cited as Special Determination S41: "Application of the financial arrangements rules to a public-private partnership agreement".

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

1. This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of asset management and facilities maintenance services in respect of a prison (the Facility) by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership.
2. The sole limited partner in the Holding Partnership will be Investor Limited Partner, a limited partnership with multiple limited partners, some of whom are exempt from income tax. The limited partners of Investor Limited Partner that are not exempt from income tax are together referred to as the Taxable Limited Partners. This determination only applies to the Taxable Limited Partners and does not apply to those limited partners that are exempt from income tax.
3. The Project Agreement comprises three basic components:
   - A design and construction phase (the D&C Phase), under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment) payable on completion of the D&C Phase;
   - Leases of part of the Existing Facility and the New Facility by the Crown to the Partnership (together, the Facility Leases), under which the Partnership pays amounts representing the rental under the Facility Leases to the Crown (the Rental Prepayments); and
   - An asset management and facilities maintenance phase (the AM/FM Phase), under which the Partnership will provide asset management and facilities maintenance services to the Crown in consideration for monthly payments (the Unitary Charge). Asset management and facilities maintenance service will be provided from the Applicable Service Commencement Date until the Actual Termination Date (a date specified in the event that the Project Agreement is terminated) or the Expiry Date, being 25 years from the Full Service Commencement Date.
4. The Partnership has entered into an Early Works Construction Subcontract with a contractor (the Contractor), under which the Contractor will provide earthworks and any associated works that are required to form the building platform for the Facility.
5. The Partnership will enter into:
   - a D&C Subcontract with the Contractor, under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and
   - an Asset Management and Facilities Maintenance Contract (the AM/FM Subcontract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going asset management and facilities maintenance (and other) services in consideration for monthly payments.
6. The Partnership will raise external debt from third party financiers (the Senior Debt). The Partnership will enter into Interest Rate Swaps in respect of the Senior Debt.
7. The Investor Limited Partner will provide investment support during the D&C Phase in the form of a standby letter of credit (the Letters of Credit) to the external lenders.
8. The Facility Leases, AM/FM Phase of the Project Agreement, Early Works Construction Subcontract, D&C Subcontract and AM/FM Subcontract are all excepted financial arrangements.
9. The D&C Phase of the Project Agreement, Senior Debt, Interest Rate Swaps and Letters of Credit are financial arrangements to which the Partnership is a party.
10. The Project, including all of these agreements, is a wider financial arrangement.
11. This determination prescribes:
    - the amount of consideration that is solely attributable to the Facility Lease;
    - how the financial arrangements rules apply to the AM/FM Phase of the Project Agreement, the Early Works Construction Subcontract, the D&C Subcontract and the AM/FM Subcontract;
    - the method for spreading the payments made under the Senior Debt, Interest Rate Swaps and Letters of Credit.

2. Reference

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

3. Scope of determination

1. This determination applies to the Partnership in respect of the Project (which is set out in detail in Private Ruling BR Prv 15/35 issued on 4 September 2015), including the following arrangements:

    - The D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation (which is the subject of *Special Determination S42: Application of the financial arrangements rules to the D&C Phase of a public-private partnership*).
    - The AM/FM Phase of the Project Agreement, under which the Partnership will provide ongoing asset management and facilities maintenance services to the Crown in consideration for monthly payments. Asset management and facilities maintenance service will be provided from the Applicable Service Commencement Date until the Actual Termination Date (a date specified in the event that the Project Agreement is terminated) or the Expiry Date, being 25 years from the Full Service Commencement Date.
    - The Facility Leases, under which the Partnership will lease the complete Facility (the New Facility Lease) and part of the existing Facility (the Existing Facility Lease) from the Crown and make the Rental Prepayments to the Crown. The leases commence from the Applicable Service Commencement Date until the Actual Termination Date (a date specified in the event that the Project Agreement is terminated) or the Expiry Date, being 25 years from the Full Service Commencement Date. The Rental Prepayment for the New Facility Lease will be equal to and will offset the D&C Payment.
    - An Early Works Construction Subcontract and a D&C Subcontract with the Contractor, under which the Contractor will design and construct the Facility in consideration for payments under the D&C Subcontract.
    - An AM/FM Subcontract with the Service Provider, under which the Service Provider will provide the ongoing asset management and facilities maintenance (and other) services in consideration for payments under the AM/FM Subcontract.
    - Senior Debt, under which the Partnership will borrow an agreed sum from external lenders for a term of 7 years from financial close of the Project (Financial Close). The Senior Debt will include a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date and a debt servicing facility. It is expected that the Senior Debt will be refinanced within 7 years of Financial Close, and every 7 years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this determination), the Senior Debt (and any subsequent re-financings) will initially be recognised at fair value plus integral fees, and subsequently measured at amortised cost using the effective interest method (regardless of whether hedge accounting is applied). The Senior Debt will not be treated as a hedge of another financial arrangement.
    - Letters of Credit, under which Investor Limited Partner will provide equity support in favour of the Holding Partnership and the Senior Lenders. The Holding Partnership will pay Investor Limited Partner an annual Investment Support Fee for the provision of the Letters of Credit. The Investment Support Fee will be an arm's length fee.
    - Interest Rate Swaps, under which the Partnership will pay a fixed rate of interest to the swap counterparties and receive a floating rate in return.

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

    - The Taxable Limited Partners use IFRS to prepare financial statements.
    - The Taxable Limited Partners will recognise income derived from the Crown during the D&C Phase of the Project Agreement and the AM/FM Phase of the Project Agreement, and will deduct expenditure incurred in relation to the Facility Leases, Early Works Construction Subcontract, D&C Subcontract and AM/FM Subcontract, in each case, under the relevant provisions of the Income Tax Act 2007 (outside of the financial arrangements rules).
    - The Taxable Limited Partners each do not use the Fair Value method for the Senior Debt if the Senior Debt is treated as a hedge of another financial arrangement under IFRS and uses for the other financial arrangement a method that is neither the IFRS financial reporting method nor the method required under Determination G29: Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure.
    - The Letters of Credit are not treated as a hedge of another financial arrangement.

- The Taxable Limited Partners will recognise income in respect of the D&C Payment in the manner prescribed by *Special Determination S42: Application of the financial arrangements rules to the D&C Phase in a public-private partnership*.
- The continued application of Private Ruling BR Prv 15/35 issued on 4 September 2015.
- The executed documentation not being materially different from the final documentation provided to Inland Revenue on 25 February 2015, 21 August 2015 and 28 August 2015 to the extent that it impacts on the scope of the determination or the application of the financial arrangements rules to the Applicants and the scope of the determination.

4. Principle

1. The Facility Leases are excepted financial arrangements under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(2) to (16) is not an amount that is taken into account under the financial arrangements rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Facility Leases that are not taken into account under the financial arrangements rules.
2. The AM/FM Phase, Early Works Construction Subcontract, D&C Subcontract and AM/FM Subcontract are "short-term agreements for sale and purchase" as defined in s YA 1, and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Partnership in respect of the AM/FM Phase, D&C Subcontract and AM/FM Subcontract are required to be spread under the financial arrangements rules.
3. The D&C Phase, Senior Debt, Interest Rate Swaps and Letters of Credit are "financial arrangements" under s EW 3. This determination specifies that the payments made to or by the Taxable Limited Partners, in proportion to their share in Investor Limited Partner, under the Senior Debt, Interest Rate Swaps, and Letters of Credit must be spread under the financial arrangements rules in accordance with this determination.
4. This determination does not deal with the treatment of the D&C Payment, which is subject to a separate determination (*Special Determination S42: Application of the financial arrangements rules to the D&C Phase in a public-private partnership*).

5. Interpretation

1. In this determination, unless the context otherwise requires:
   - All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
   - Capitalised terms have the same meaning as set out in the Project Agreement.
   - "Applicable Service Commencement Date" for the Existing Facility is the Existing Facility Service Commencement Date and for the New Facility is the Full Service Commencement Date.
   - "Existing Facility Lease" means the lease of part of the Existing Facility.
   - "Facility Leases" means the Existing Facility Lease and the New Facility Lease.
   - "IFRS" means International Financial Reporting Standards as defined in s YA 1.
   - "New Facility Lease" means the lease of the New Facility.
   - "Project Agreement" is a public-private partnership agreement between the Partnership and Her Majesty, the Queen in right of New Zealand acting by and through the Chief Executive of the Department of Corrections (the Crown).
   - "Rental Prepayments" mean the rent payable under the New Facility Lease and the Existing Facility Lease that is to be prepaid.
   - "Senior Debt" means the external debt financing arrangements including the Construction Facility, the Term Facility and the Debt Service Reserve Facility.

6. Method

1. The Rental Prepayments paid in respect of the Facility Leases, and the property interest granted to the Partnership under the Facility Leases, are solely attributable to the Facility Leases and are not taken into account under the financial arrangements rules.
2. The Taxable Limited Partners are not required to spread any amounts under the financial arrangements rules in respect of the:
   - AM/FM Phase of the Project Agreement;
   - Early Works Construction Subcontract;
   - D&C Subcontract; and
   - AM/FM Subcontract.

3. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Senior Debt and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.
4. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of any subsequent refinancing of the Senior Debt over the term of the relevant refinancing, provided that the terms of any such refinancing are materially similar to the terms of the Senior Debt. This determination paragraph does not affect the Taxable Limited Partners' obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.
5. None of the mandatory spreading methods in ss EW 15H or EW 15I apply to the Interest Rate Swaps. Over the term of the Interest Rate Swaps, income or expenditure may be allocated using either:
   - the expected value method in s EW 15F (other than "non-contingent fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which the "fair value method" is used, or
   - the IFRS financial reporting method in s EW 15D (other than "non-integral fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which a method other than the IFRS financial reporting method is used,

   provided that each Taxable Limited Partner uses the same method for the entire term of the Interest Rate Swaps.
6. This determination does not affect the Taxable Limited Partners' obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps.
7. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Letters of Credit. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.

7. Example

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

This example is based on the following parameters:

Commencement of D&C Phase	1 July 2015
Completion of D&C Phase	30 June 2020
Completion of O&M Phase	30 June 2045
D&C Payment from the Crown	$1,000
Aggregate payments to the Contractor	($850)
Facility Lease prepayment	($1,000)
Monthly payments from the Crown during the O&M Phase	$30
Monthly payments to the Service Provider	($15)
Annual interest on the Senior Debt	($85)
Annual net payments in respect of the Interest Rate Swaps	($7)
Annual Investment Commitment Fee for the Letters of Credit	($7)

The Taxable Limited Partners are not required to spread any amounts under the financial arrangements rules in respect of the Facility Leases, AM/FM Phase of the Project Agreement, Early Works Construction Subcontract, D&C Subcontract and AM/FM Subcontract.

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

- Interest on the Senior Debt calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F or the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Letters of Credit calculated in accordance with the IFRS financial reporting method in s EW 15D; and
- Amounts in respect of the D&C Payment as specified in *Special Determination S42: Application of the financial arrangements rules to the D&C Phase in a public-private partnership*.

This Determination is signed by me on the 4th day of September 2015

Howard Davis

Director (Taxpayer Rulings)

SPECIAL DETERMINATION S42: APPLICATION OF THE FINANCIAL ARRANGEMENTS RULES TO THE D&C PHASE OF A PUBLIC-PRIVATE PARTNERSHIP AGREEMENT

This Determination may be cited as Special Determination S42: "Application of the financial arrangements rules to the D&C Phase of a public-private partnership agreement".

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

1. This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of asset management and facilities maintenance services in respect of a prison (the Facility) by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership.
2. The sole limited partner in the Holding Partnership will be Investor Limited Partner, a limited partnership with multiple limited partners, some of whom are exempt from income tax. The limited partners of Investor Limited Partner that are not exempt from income tax are together referred to as the Taxable Limited Partners. This determination only applies to the Taxable Limited Partners and does not apply to those limited partners that are exempt from income tax.
3. The Project Agreement comprises three basic components:
    - A design and construction phase (the D&C Phase), under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment) payable on completion of the D&C Phase;
    - Leases of part of the Existing Facility and the New Facility by the Crown to the Partnership (together the Facility Leases), under which the Partnership pays amounts representing the rental under the Facility Leases to the Crown (the Rental Prepayments); and
    - An asset management and facilities maintenance phase (the AM/FM Phase), under which the Partnership will provide asset management and facilities maintenance services to the Crown in consideration for monthly payments (the Unitary Charge). Asset management and facilities maintenance service will be provided from the Applicable Service Commencement Date (ie, for the Existing Facility from the Existing Facility Service Commencement Date and for the New Facility from the Full Service Commencement Date) until the Actual Termination Date (a date specified in the event that the Project Agreement is terminated) or the Expiry Date, being 25 years from the Full Service Commencement Date.
4. The Partnership has entered into an Early Works Construction Subcontract with a contractor (the Contractor), under which the Contractor will provide earthworks and any associated works that are required to form the building platform for the Facility.
5. The Partnership will enter into:
    - a D&C Subcontract with the Contractor, under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and
    - an Asset Management and Facilities Maintenance Contract (the AM/FM Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going asset management and facilities maintenance (and other) services in consideration for monthly payments.
6. The Partnership will raise external debt from third party financiers (the Senior Debt). The Partnership will enter into Interest Rate Swaps in respect of the Senior Debt. The Investor Limited Partner will provide investment support during the D&C Phase in the form of a standby letter of credit (the Letters of Credit) to the external lenders.
7. The Facility Leases, AM/FM Phase of the Project Agreement, Early Works Construction Subcontract, D&C Subcontract and AM/FM Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Senior Debt, Interest Rate Swaps and Letters of Credit are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement. *Special Determination S41: Application of the financial arrangements rules to a public-private partnership* applies to arrangements in the wider financial arrangement, excluding the D&C Payment.
8. This determination prescribes the portion of the D&C Payment treated as income under the financial arrangements rules (the Interest Component) and the method for spreading that income.

2. Reference

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

3. Scope of determination

1. This determination applies to the Partnership in respect of the D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) once the Facility is ready for operation.
2. This determination is made subject to the following conditions:
   - The design and construction costs of the Facility are agreed between the Partnership and the Crown on an arm's length basis and set out in the Base Case under the Project Agreement as referenced to in the definition of "Design and Construction Payment" in Clause 1.1 of the Project Agreement.
   - The Taxable Limited Partners use IFRS to prepare financial statements and to report for financial arrangements.
   - The Taxable Limited Partners will recognise income derived from the Crown during the D&C Phase of the Project Agreement and deduct expenditure incurred in relation to the Early Works Construction Subcontract and D&C Subcontract under the relevant provisions of the Income Tax Act 2007 (outside of the financial arrangements rules).
   - The continued application of private ruling BR Prv 15/35 issued on 4 September 2015.
   - The executed documentation not being materially different from the final documentation provided to Inland Revenue on 25 February 2015, 21 August 2015 and 28 August 2015 to the extent that it impacts on the scope of the determination or the application of the financial arrangements rules to the Applicants and the scope of the determination.

4. Principle

1. During the D&C Phase of the Project Agreement, the Partnership will receive consideration from the Crown (in the form of the D&C Payment) and will in turn provide consideration to the Crown (in the form of the completion of the Facility and the transfer of its rights, set out in Clause 11.2(c) of the Project Agreement, in the Facility). The D&C Phase of the Project Agreement is a "financial arrangement" under s EW 3 and an "agreement for the sale and purchase of property or services" under s YA 1.
2. The Partnership and the Crown have agreed that the D&C Payment includes capitalised interest (Clause 12.8(c) of the Project Agreement). The Interest Component of the D&C Payment will be income under the financial arrangements rules under subpart EW.
3. During the D&C Phase the Partnership will accrue variable expenditure commitments. The capitalised interest component of the D&C Payment is intended to offset the expected funding costs incurred in relation to these commitments.
4. The Interest Component is calculated with reference to expected funding costs. No adjustment is made for variances between actual and expected costs as the D&C Payment, including capitalised interest, is agreed in advance.
5. The Interest Component needs to be spread over the term of the D&C Phase.

5. Interpretation

1. In this determination, unless the context otherwise requires:
   - All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
   - Capitalised terms have the same meaning as set out in the Project Agreement.
   - "IFRS" means International Financial Reporting Standards as defined in s YA 1.
   - "Project Agreement" is a public-private partnership agreement between the Partnership and Her Majesty, the Queen in right of New Zealand acting through the Chief Executive of the Department of Corrections (the Crown)

6. Method

Calculation of Interest Component of D&C Payment

1. The value of the completed Facility and transfer of the Partnership's rights to the Crown, set out in Clause 11.2(c) of the Project Agreement, is the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement.
2. The D&C Payment, less the agreed design and construction costs of the Facility (excluding Fitout) set out in the Base Case under the Project Agreement, is the Interest Component that is income under the financial arrangements rules.
3. BR Prv 15/35 rules on the portion of the D&C Payment that is not income under the financial arrangements rules and is not considered in this determination.

Spreading of Interest Component of D&C Payment

4. The method for determining the amount of income that is to be allocated to each income year is as follows:

   a) The expected design and construction costs of the Facility (excluding Fitout) as set out in the Base Case are treated as having been incurred at the beginning of each of the income years that make up the D&C Phase (the Annual Expenditure). No adjustment will be made to the Annual Expenditure in any income year to reflect actual expenditure in that year.

   b) The interest allocated to each income year is then calculated in accordance with the following formula:

      Interest = $OB \times R$

      Where:

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

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

7. Example

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

The Partnership and the Crown agree under the Base Case sheet that the D&C Payment equals $250,000.

The Base Case sets out that the agreed design and construction costs of the Facility (excluding Fitout) are to be $240,000.

The value of the "completed Facility and the transfer of the rights set out in Clause 11.2(c)" of the Project Agreement, as set out in Clause 12.6 of the Project Agreement, is equal to $250,000.

The Interest Component of the D&C Payment is $10,000 by implication of the valuation under this determination.

The Limited Partners will spread the Interest Component over the term of the D&C Phase of the Project Agreement, as follows.

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

Year	Actual D&C costs
1	($31,000)
2	($77,000)
3	($130,000)
4	($2,000)
D&C Payment	$250,000
	($240,000)

Based on receipt of the $250,000 D&C Payment in Year 4 the Project has an internal rate of return of 1.5980%.

The Interest Component is therefore spread as follows:

Year	Actual D&C costs	Cumulative	Interest income
1	($31,000)	($31,000)	$495
2	($77,000)	($108,495)	$1,734
3	($130,000)	($240,229)	$3,839
4	($2,000)	($246,068)	$3,932
D&C Payment		$250,000	
	($240,000)		$10,000

This Determination is signed by me on the 4th day of September 2015

Howard Davis

Director (Taxpayer Rulings)

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS (FOR THE SIX MONTHS ENDING 30 SEPTEMBER 2015)

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company ("CFC") and foreign investment fund ("FIF") rules for the six months ending 30 September 2015.

The Income Tax Act 2007 ("2007 Act") requires foreign currency amounts to be converted into New Zealand dollars applying one of the following methods:

- actual rate for the day for each transaction (including close of trading spot exchange rate on the day), or
- rolling 12-month average rate for a 12-month accounting period or income year (see the table **Currency rates 6 months ending 30 September 2015 – rolling 12-month average**), or
- mid-month actual rate as the basis of the rolling average for accounting periods or income years greater or lesser than 12 months (see the table **Currency rates 6 months ending 30 September 2015 – mid-month actual**).

Legislation enacted in September 2010 with effect from 1 April 2008 permits the Commissioner to set currency rates and approve methods of calculating exchange rates. The Commissioner can set rates for general use by taxpayers or for specific taxpayers. The Commissioner's ability to set rates and approve methods applies in circumstances where the 2007 Act does not contain a specific currency conversion rule (sections YF 1(5) and (6)), or in circumstances where the 2007 Act provides a rate or method for currency conversion (section YF 2).

Inland Revenue uses wholesale rates from Bloomberg for rolling 12-month average, mid-month actual and end of month. These rates are provided in three tables.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note: All section references relate to the 2007 Act.

Actual rate for the day for each transaction

The actual rate for the day for a transaction can be used in the following circumstances:

- where the 2007 Act does not provide a specific currency conversion rule, then foreign currency amounts can be converted by applying the close of trading spot exchange rate on the date the transaction is required to be measured or calculated (section YF 1(2))
- where a person chooses to use the actual rate for the day of the transaction when calculating their FIF income or loss by applying the comparative value method, fair dividend rate method, deemed rate of return method or the cost method (section EX 57(2)(a))
- where a person chooses to use the close of trading spot exchange rate to convert foreign income tax paid by a CFC (section LK 3(a)) or by a FIF where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(a)).

Unless the actual rate is the rate for the 15th or the last day of the month, these rates are not supplied by Inland Revenue.

The table **Currency rates 6 months ending 30 September 2015 – month end** provides exchange rates for the last day of the month. These are provided for convenience to assist taxpayers who may need exchange rates on those days.

Currency rates 6 months ending 30 September 2015 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average. This table should be used where the accounting period or income year encompasses 12 complete months.

This table can be used to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods of 12 months
- FIF income or loss calculated under the attributable FIF income method (sections EX 21(4)(b) and EX 50(3)(a)) for accounting periods of 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of 12 months
- calculating the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or

under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of 12 months.

Currency rates 6 months ending 30 September 2015 – mid-month actual table

This table sets out the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted. This table can be used as the basis of the rolling average where the accounting period or income year is less than or greater than 12 months (see Example 4). You can also use the rates from this table as the actual rate for any transactions arising on the 15th of the month.

This table can be used as the basis of the rolling average for calculating:

- FIF income or loss under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods or income years of less than or greater than 12 months
- FIF income or loss calculated under the attributable FIF income method (sections EX 21(4)(b) and EX 50(3)(a)) for accounting periods of less than or greater than 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of less than or greater than 12 months
- the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippine company (which is a FIF but does produce a guaranteed yield) on 7 September 2015. Its opening market value on 1 October 2015 or its closing market value on 30 September 2015 is PHP 350,000. Using the comparative value method and applying the actual rate for the day (section EX 57(2)(a)), the opening market value is converted as follows:

PHP 350,000 ÷ 29.8648 = $11,719.48

(In this example, the rate selected is the month-end rate for September 2015 for PHP. Refer to the table "Currency rates 6 months ending 30 September 2015 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 30 June 2015. Attributed CFC income for the period 1 July 2014 to 30 June 2015 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 6.0582 = $33,013.11

(In this example, the rate selected is the rolling 12-month average rate for June 2015 for HKD. Refer to the table "Currency rates 6 months ending 30 September 2015 – rolling 12-month average".)

Example 3

A resident individual with a 30 September 2015 accounting period acquired a FIF interest in a Japanese company on 1 October 2014 for 10,500,000 yen. The interest is sold in September 2015 for 10,000,000 yen. Using the comparative value method and applying section EX 57(2)(b), these amounts are converted as:

JPY 10,500,000 ÷ 86.8026 = $120,964.12

JPY 10,000,000 ÷ 86.8026 = $115,203.92

(In this example, the rolling 12-month rate for September 2015 for JPY has been applied to both calculations. Refer to the table "Currency rates 6 months ending 30 September 2015 – rolling 12-month average".)

Example 4

A CFC resident in Singapore was formed on 20 April 2015 and has a balance date of 30 September 2015. During the period 1 May 2015 to 30 September 2015, attributed CFC income of 500,000 Singaporean dollars was derived. For the conversion to New Zealand dollars the taxpayer chooses the method set out in section EX 21(4)(b).

1. Calculating the average monthly exchange rate for the complete months May–September 2015:

   0.9871 + 0.9424 + 0.8998 + 0.9209 + 0.8912 = 4.6414

   4.6414 ÷ 5 = 0.92828

2. Round exchange rate to four decimal places: 0.9283

3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 0.9283 = $538,618.98

(In this example, the rates are from the table "Currency rates 6 months ending 30 September 2015 – mid-month actual", from May to September 2015 inclusive for SGD.)

Currency rates 6 months ending 30 September 2015 – rolling 12-month average

Currency	Code	15/04/15	15/05/15	15/06/15	15/07/15	15/08/15	15/09/15
Australia Dollar	AUD	0.9343	0.9348	0.9331	0.9295	0.9273	0.9260
Bahrain Dinar	BHD	0.3035	0.2999	0.2946	0.2878	0.2817	0.2759
Britain Pound	GBH	0.5047	0.5014	0.4962	0.4887	0.4812	0.4737
Canada Dollar	CAD	0.9238	0.9202	0.9137	0.9060	0.9003	0.8952
China Yuan	CNY	4.9835	4.9213	4.8347	4.7221	4.6351	4.5539
Denmark Kroner	DKK	4.8409	4.8548	4.8423	4.8150	4.7881	4.7468
Euporean Community Euro	EUR	0.6497	0.6516	0.6499	0.6462	0.6425	0.6369
Fiji Dollar	FJD	1.5563	1.5487	1.5364	1.5188	1.5048	1.4903
French Polynesia Franc	XPF	77.5617	77.7848	77.5816	77.1383	76.6937	76.0188
Hong Kong Dollar	HKD	6.2417	6.1661	6.0582	5.9176	5.7919	5.6742
India Rupee	INR	49.2100	48.8667	48.2880	47.4116	46.6606	46.0066
Indonesia Rupiah	IDR	9,816.9542	9,801.9825	9,724.2275	9,608.1408	9,533.1683	9,480.8217
Japan Yen	JPY	88.8791	88.9902	88.8208	88.1878	87.7283	86.8026
Korea Won	KOR	856.8775	850.2997	841.7076	829.6529	821.9033	813.6030
Kuwait Dinar	KWD	0.2330	0.2315	0.2287	0.2247	0.2211	0.2176
Malaysia Ringit	MYR	2.7098	2.6979	2.6838	2.6622	2.6614	2.6694
Norway Krone	NOK	5.5111	5.5377	5.5572	5.5513	5.5677	5.5661
Pakistan Rupee	PKR	81.1210	80.3598	79.1897	77.5361	76.0295	74.5455
Phillipines Peso	PHP	35.4970	35.1030	34.5648	33.8880	33.3139	32.7753
PNG Kina	PGK	2.0592	2.0295	2.0119	1.9848	1.9619	1.9435
Singapore Dollar	SGD	1.0423	1.0344	1.0226	1.0067	0.9954	0.9835
Solomon Islands Dollar*	SBD	0.1086	0.1068	0.1045	0.1016	0.0988	0.0964
South Africa Rand	ZAR	9.0318	9.0168	8.9687	8.8681	8.8174	8.7837
Sri Lanka Rupee	LKR	105.6146	104.5847	103.0830	100.9880	99.0386	97.6139
Sweden Krona	SEK	6.0148	6.0515	6.0475	6.0161	5.9949	5.9500
Swiss Franc	CHF	0.7453	0.7382	0.7274	0.7142	0.7037	0.6916
Taiwan Dollar	TAI	24.7093	24.4296	24.0653	23.5790	23.2129	22.8794
Thailand Baht	THB	26.1597	25.9024	25.5288	25.0580	24.7235	24.4277
Tonga Pa'anga*	TOP	1.5130	1.5036	1.4902	1.4719	1.4553	1.4405
United States Dollar	USD	0.8049	0.7951	0.7813	0.7631	0.7470	0.7318
Vanuatu Vatu	VUV	79.7259	79.5159	78.8478	77.7308	76.9628	76.1482
West Samoan Tala*	WST	1.8751	1.8638	1.8474	1.8092	1.7899	1.7720

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 6 months ending 30 September 2015 – mid-month actual

Currency	Code	15/04/15	15/05/15	15/06/15	15/07/15	15/08/15	15/09/15
Australia Dollar	AUD	0.9885	0.9297	0.9014	0.8932	0.8841	0.8900
Bahrain Dinar	BHD	0.2863	0.2818	0.2639	0.2485	0.2466	0.2398
Britain Pound	GBH	0.5117	0.4753	0.4486	0.4214	0.4177	0.4142
Canada Dollar	CAD	0.9333	0.8980	0.8627	0.8511	0.8557	0.8421
China Yuan	CNY	4.7124	4.6382	4.3457	4.0915	4.1786	4.0481
Denmark Kroner	DKK	5.3087	4.8732	4.6270	4.4913	4.3979	4.2086
Euporean Community Euro	EUR	0.7112	0.6528	0.6203	0.6020	0.5887	0.5643
Fiji Dollar	FJD	1.5562	1.5008	1.4472	1.4002	1.4011	1.3751
French Polynesia Franc	XPF	84.8498	77.9088	74.0251	71.8011	70.2607	67.3010
Hong Kong Dollar	HKD	5.8873	5.7933	5.4267	5.1079	5.0674	4.9259
India Rupee	INR	46.8099	47.2459	44.7657	42.4277	42.6636	42.0557
Indonesia Rupiah	IDR	9,683.1300	9,747.4700	9,289.5200	8,927.5200	9,018.2200	9,113.1500
Japan Yen	JPY	90.4590	89.1270	86.3820	81.5570	81.3370	76.5320
Korea Won	KOR	829.7204	810.4685	781.6806	756.2151	770.7892	749.3905
Kuwait Dinar	KWD	0.2292	0.2249	0.2113	0.1995	0.1977	0.1920
Malaysia Ringit	MYR	2.7808	2.6549	2.6206	2.5446	2.6693	2.7235
Norway Krone	NOK	5.9417	5.4624	5.4268	5.3741	5.4019	5.2080
Pakistan Rupee	PKR	77.5194	76.3359	71.4286	67.1141	66.6667	66.2252
Phillipines Peso	PHP	33.4258	33.1325	31.4921	30.2562	30.2048	29.5524
PNG Kina	PGK	2.0314	2.0121	1.9102	1.8234	1.8141	1.7984
Singapore Dollar	SGD	1.0306	0.9871	0.9424	0.8998	0.9209	0.8912
Solomon Islands Dollar*	SBD	0.0987	0.0972	0.0910	0.0863	0.0841	0.0826
South Africa Rand	ZAR	9.1620	8.8137	8.6807	8.1825	8.3833	8.5600
Sri Lanka Rupee	LKR	101.0101	100.0000	94.3396	88.4956	87.7193	89.2857
Sweden Krona	SEK	6.6283	6.1222	5.7133	5.6058	5.5450	5.2794
Swiss Franc	CHF	0.7325	0.6840	0.6506	0.6273	0.6394	0.6190
Taiwan Dollar	TAI	23.7048	22.7446	21.6343	20.4946	21.0456	20.6535
Thailand Baht	THB	24.6337	25.0234	23.5670	22.5305	23.0472	22.8371
Tonga Pa'anga*	TOP	1.4829	1.4690	1.3955	1.3522	1.3501	1.3556
United States Dollar	USD	0.7592	0.7474	0.7000	0.6590	0.6547	0.6355
Vanuatu Vatu	VUV	80.6452	78.1250	74.6269	69.9301	71.4286	68.9655
West Samoan Tala*	WST	1.8051	1.7876	1.7199	1.6393	1.6450	1.6295

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 6 months ending 30 September 2015 – month end

Currency	Code	30/04/15	31/05/15	30/06/15	31/07/15	31/08/15	30/09/15
Australia Dollar	AUD	0.9635	0.9294	0.8779	0.9017	0.8913	0.9118
Bahrain Dinar	BHD	0.2871	0.2679	0.2551	0.2484	0.2393	0.2415
Britain Pound	GBH	0.4961	0.4646	0.4306	0.4219	0.4132	0.4229
Canada Dollar	CAD	0.9198	0.8852	0.8454	0.8629	0.8331	0.8519
China Yuan	CNY	4.7211	4.4069	4.2000	4.0906	4.0421	4.0672
Denmark Kroner	DKK	5.0658	4.8241	4.5310	4.4779	4.2212	4.2711
Euporean Community Euro	EUR	0.6786	0.6471	0.6074	0.6002	0.5655	0.5725
Fiji Dollar	FJD	1.5401	1.4760	1.4168	1.4108	1.3746	1.3916
French Polynesia Franc	XPF	80.9338	77.2239	72.4045	71.6045	67.4161	68.3423
Hong Kong Dollar	HKD	5.9030	5.5110	5.2438	5.1101	4.9131	4.9588
India Rupee	INR	48.2597	45.4983	43.0223	41.9718	42.5920	41.8558
Indonesia Rupiah	IDR	9,869.86	9,411.36	9,032.86	8,867.28	9,030.70	9,345.54
Japan Yen	JPY	90.8960	88.2300	82.8610	81.6780	76.8560	76.7030
Korea Won	KOR	820.4457	791.5920	757.6760	768.9223	750.1522	758.3961
Kuwait Dinar	KWD	0.2297	0.2154	0.2046	0.1997	0.1916	0.1934
Malaysia Ringit	MYR	2.7125	2.6104	2.5534	2.5089	2.6915	2.8070
Norway Krone	NOK	5.7368	5.5205	5.3161	5.3897	5.2501	5.4484
Pakistan Rupee	PKR	77.5194	72.4638	68.9655	67.1141	65.7895	66.6667
Phillipines Peso	PHP	33.9462	31.7401	30.5262	29.9570	30.0331	29.8648
PNG Kina	PGK	2.0419	1.9133	1.8564	1.8282	1.7786	1.8364
Singapore Dollar	SGD	1.0081	0.9579	0.9114	0.9047	0.8950	0.9102
Solomon Islands Dollar*	SBD	5.7940	5.4061	5.1650	5.1206	4.9352	5.1054
South Africa Rand	ZAR	9.0728	8.6453	8.2322	8.3591	8.4185	8.8644
Sri Lanka Rupee	LKR	101.0101	95.2381	90.9091	88.4956	85.4701	90.0901
Sweden Krona	SEK	6.3460	6.0562	5.6075	5.6855	5.3713	5.3549
Swiss Franc	CHF	0.7102	0.6683	0.6331	0.6360	0.6132	0.6228
Taiwan Dollar	TAI	23.3152	21.9028	20.9010	20.8729	20.6006	21.0974
Thailand Baht	THB	25.1412	23.9549	22.8644	23.0792	22.7232	23.2652
Tonga Pa'anga*	TOP	1.4962	1.3969	1.3546	1.3566	1.3074	1.4021
United States Dollar	USD	0.7617	0.7107	0.6765	0.6592	0.6340	0.6399
Vanuatu Vatu	VUV	80.6452	74.0741	70.9220	71.4286	68.9655	71.9424
West Samoan Tala*	WST	1.9138	1.7208	1.6622	1.6480	1.6173	1.6535

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

ITEMS OF INTEREST

FIVE YEARS ON FOR FACILITATED CONFERENCES

While those familiar with working through disputes with Inland Revenue may be aware of the opportunity for a facilitated conference, many will not.

Facilitation of tax disputes conferences was introduced five years ago. It is a form of Alternative Dispute Resolution (ADR) and its introduction followed discussions with the New Zealand Law Society and the New Zealand Institute of Chartered Accountants on their joint submission to the Minister of Revenue recommending reforms to the disputes resolution and challenge procedures.

New Zealand's disputes process, unlike most overseas tax jurisdictions, takes place pre assessment, ie, before Inland Revenue makes any amendment to a taxpayer's self-assessment. Facilitated conferences occur in the middle of the disputes process, after an initial formal exchange of information between the parties through a notice of proposed adjustment and a notice of response, and before the final formal exchange of information through statements of position which ultimately defines the dispute between the parties. At this stage, the dispute will be reviewed (on the papers) by Inland Revenue's Disputes Review Unit, who are independent and separate from others involved in the dispute.

Facilitated conferences are open to all in the disputes process. It provides an opportunity to try and resolve differences in the understanding of the facts, the law and the arguments being put forward by both parties through the involvement of an independent internal facilitator. The facilitator does not have any formal decision making powers but works with the parties to seek resolution. If appropriate, the facilitator can assist the parties to hold settlement discussions but this will be separate from any facilitated conference.

Five years on, over 500 facilitated conferences have been held, with over half that number occurring in the last two years. Around 55% of all facilitated conferences achieved resolution of the dispute.

Conference facilitators are senior, experienced, Inland Revenue officers who have had no prior involvement with the dispute and who, as such, will generally be from another regional office and/or business area. Training for facilitators is provided by the Arbitrators and Mediators Institute of New Zealand Inc (AMINZ). Inland Revenue has a pool of 40 to 50 trained facilitators.

New Zealand is not the only country to adopt the use of independent internal facilitators as a form of alternative disputes resolution. Since the introduction in New Zealand, both Australia and the United Kingdom Revenue Authorities have piloted similar approaches in dealing with targeted areas of disputes before making it more generally available.

Inland Revenue remains committed to facilitated conferences and the benefit they can provide to all involved. To provide greater external assurance as to the expertise of the facilitators used, Inland Revenue is now moving to accredit its facilitators with AMINZ. In addition, to assist people with a broader understanding of the disputes process, Inland Revenue is updating the information on its website and will be producing a short video on the process and how it works.

This article by Karen Whitiskie was previously published in *Lawtalk*, 873, 11 September 2015, p 19.

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, Privy Council and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

STRIKE-OUT GRANTED

Case	TRA 002/12 [2015] NZTRA 14 (Supplementary ruling)
Decision date	16 September 2015
Act(s)	Goods and Services Tax Act 1985, Tax Administration Act 1994, Taxation Review Authorities Act 1994
Keywords	Strike-out, delay, frivolous, vexatious

Summary

The Commissioner of Inland Revenue ("the Commissioner") applied to strike-out these proceedings on the grounds that they were brought solely for the purposes of delay. The Commissioner's application was granted subject to the disputants' tax agent complying with certain conditions stipulated in the Taxation Review Authority's ("the Authority") ruling of 17 July 2015.

Although the disputants did not comply with these conditions, the Authority set down a date for a hearing. The disputants then applied to have Judge Barber recused. The Commissioner subsequently sought to have the proceeding immediately struck out as it had become apparent the hearing would not serve the purposes it was intended for. The strike-out was granted.

Impact

The Authority is hesitant to deprive a disputant of having their challenge considered by the Authority due to the conduct of the challenge by the disputant's tax agent. However, the Authority will strike out a challenge if it is brought for purposes of delay, is frivolous or vexatious or there is a failure to comply with an unless order.

Facts

On 18 May 2015, the Authority made an unless order which the disputants failed to comply with. On 26 June 2015, the Commissioner applied to strike out the disputants' challenge as being solely for the purposes of delay, being frivolous and vexatious and failing to comply with the unless order. On 27 July 2015, the Authority delivered a ruling outlining why the Commissioner's strike-out application should be granted, subject to the disputants being able to take certain steps to progress the matter. The Authority acknowledged that the matter should have ended but was concerned about depriving the disputants of a "proper resolution" of their challenge. Accordingly, the Authority granted the disputants one month to engage legal counsel, provide evidence briefs and file opening submissions. The strike-out order became subject to these conditions (*TRA 002/12* [2015] NZTRA 11 at [125]).

The disputants' tax agent did not comply with these conditions. The Authority again acknowledged that the strike-out should take effect and the matter be at an end. However, a hearing date was set down in November 2015. This was done to allow the disputants a chance to cross-examine current and former Inland Revenue staff in relation to the assessments being challenged.

On 8 September 2015, the disputants' tax agent filed a memorandum seeking to recuse Judge Barber and a claim for costs against a Crown solicitor. In response, counsel for the Commissioner filed a memorandum outlining why the hearing set down for November would not achieve the purposes set out in the Authority's earlier Minute.

Decision

The Authority, dealing with the matter on the papers, agreed with the submissions made by the Commissioner and concluded that "[t]he time has come to bring the matter to an end" (*TRA 002/12* [2015] NZTRA 14 (Supplementary ruling) at [19]).

The Authority found the disputants had not complied with the unless order of 18 May 2015, as covered in its ruling of 27 July 2015. Accordingly, the disputants' challenge was struck out and dismissed.

APPLICATION TO SET ASIDE BANKRUPTCY NOTICE DECLINED

Case	John George Russell v Commissioner of Inland Revenue
Decision date	28 September 2015
Act(s)	Insolvency Act 2006
Keywords	Proposal, bankruptcy notice, just and equitable, public interest, integrity of the tax system

Summary

The High Court declined Mr Russell's application for approval of payment terms of $1,000 per week. Accordingly, the High Court declined to set aside the bankruptcy notice issued to Mr Russell by the Commissioner of Inland Revenue ("the Commissioner").

Impact

The duty to maximise the recovery of outstanding tax does not mean the Commissioner is required to accept any repayment proposal made to her. Preserving the integrity of the tax system and promoting compliance by other taxpayers are engaged when considering whether to set aside a bankruptcy notice.

Facts

Mr Russell owes the Commissioner, his sole creditor, a debt of over $400 million as a result of tax liabilities, penalties and interest accrued over a period of years.

Mr Russell applied to the High Court to exercise its discretion and approve his proposal in respect of his judgment debt and to set aside a bankruptcy notice issued by the Commissioner in respect of his proposed bankruptcy.

Mr Russell's proposal was:

a) to pay the Commissioner $1,000 per week for the rest of his life; and

b) to permit the Commissioner to prove in his deceased estate for the remainder of any debt claimed to be owing to her at the time of his death.

Mr Russell had previously made a proposal to the Commissioner on terms substantively similar to the current proposal that was refused and Mr Russell was not successful in his subsequent application to have the refusal judicially reviewed.

The Commissioner opposed the proposal on the basis that she not only has a duty to maximise the recovery of outstanding tax but also to preserve the integrity of the tax system, including promoting taxpayer compliance.

Decision

The Court acknowledged that in reality Mr Russell's proposal is concerned with a disguised write-off of a massive debt owed to the Commissioner, which he openly acknowledges neither he nor his estate can pay.

Mr Russell's application was made on a somewhat confused basis. Initially he purported to rely on s 29(1)(b)(iii) of the Insolvency Act 2006, contending that the subsection required the Commissioner to accept an adequate compromise if one were made. At the hearing it became clear that Mr Russell's argument was that he was unable to pay the debt, he had made an informal proposal for a modest part-payment and that should be sufficient justification for the Court to exercise its discretion so as to pre-empt Mr Russell being adjudicated bankrupt.

The Court does have an inherent jurisdiction to set aside bankruptcy notices but this is aimed at preventing serious abuses of processes arising from procedural defects. No allegation made in this case could found an application under that inherent jurisdiction.

Associate Judge Sargisson identified issues of res judicata and issue estoppel as the present application traversed almost exactly the same ground as the judicial review proceedings. If the High Court here were to reach a conclusion that would allow Mr Russell to impose his proposal on the Commissioner, it would amount to a collateral attack on the High Court and Court of Appeal judgments in the judicial review.

Mr Russell also contended that the Court should consider how the debt came about, that it was attributed to him as a debt he was responsible for despite actually being incurred by various companies and this was a factor that weighed against allowing the bankruptcy to proceed. Associate Judge Sargisson found that to do so would be a collateral attack on decisions of the Taxation Review Authority, High Court, Court of Appeal, as well as possibly the Supreme Court and she cannot, and will not, differ from the Courts' previous conclusions on the legitimacy of the debt.

In response to Mr Russell's argument that bankruptcy would not be a just and equitable outcome, Associate Judge Sargisson found his arguments unconvincing. Though the Commissioner has a duty to recover as much tax as possible, that does not mean accepting any proposal made to her. The goals of preserving the integrity of the tax system and promoting compliance by other taxpayers are reasonable ones. The Court agreed with the Commissioner that in the present situation where Mr Russell has knowingly engaged in large-scale tax avoidance over a period of years and wasted large amounts of public money on unmeritorious challenges, the broader public interest considerations are clearly not to set aside the bankruptcy notice.

The Court noted how the core tax debt was a very small proportion of the total debt, but the situation was one of Mr Russell's own making created by his failure to recognise the core debt and either pay it or reach a compromise with Inland Revenue at an early stage.

Mr Russell's "informal" proposal was demonstrably not a ground for setting aside the bankruptcy notice. Associate Judge Sargisson dismissed the application, declined to set aside the bankruptcy notice issued by the Commissioner and held that the Commissioner may proceed with filing an application for adjudication.

BUSINESS CEASED AND NO NEXUS WITH INCOME-EARNING ACTIVITIES

Case	AAA Developments (Ormiston) Limited v Commissioner of Inland Revenue [2015] NZHC 2318
Decision date	23 September 2015
Act(s)	Income Tax Act 2007
Keywords	Business, nexus, revenue account property

Summary

The taxpayer, AAA Developments (Ormiston) Ltd ("AAA"), was a property developer that entered into a sale and purchase agreement to purchase a parcel of land for a retail and residential development and paid a series of deposits. Issues arose between AAA and the vendor, with both trying to walk away from the agreement. In litigation between the parties, the High Court found the sale and purchase agreement was binding and neither party could cancel it. The parties subsequently settled their dispute as to the balance of the deposits.

AAA returned its costs of that litigation and the part of the deposits it could not recover as deductible for income tax purposes, claiming they were incurred in the course of its business and/or were part of the costs of its revenue account land acquisition. The Commissioner of Inland Revenue ("the Commissioner") made new assessments disallowing the deductions on the basis that AAA's business had ceased prior to the sale and purchase agreement litigation and any expenditure after that date had no nexus with the income-earning activities of AAA.

AAA unsuccessfully challenged the Commissioner's assessments in the Taxation Review Authority ("the Authority") and appealed to the High Court.

Impact

The judgment reaffirms the two-stage inquiry for a business in the tax context:

- the nature of the activities carried on, and
- the intention of the taxpayer in engaging in those activities.

The general deductibility permission in s DA 1 of the Income Tax Act 2007 must still be satisfied for revenue account property. Where it is prejudicial to a party, the Court may decline leave to raise new arguments in an appeal that were not in the statement of position or notice of claim, and are inconsistent with the agreed statement facts.

Facts

This is an appeal by the taxpayer, AAA, of a decision by the Authority that concerned the income tax treatment of certain expenditure incurred by AAA, a property developer formed in 2005.

In February 2006, AAA agreed to acquire a parcel of land ("the Land") for a retail and residential development and paid a series of deposits. The agreement was conditional on the vendor obtaining resource consent for the subdivision of a larger property to obtain title for the Land to be sold to AAA. Issues arose between the parties and at various times each party tried to walk away from the agreement. In subsequent litigation the High Court found that the agreement was binding and neither party could cancel it, with the consequence that AAA was unable to recover a large part of the purchase deposit it had paid.

AAA contended that the litigation costs and the part of the purchase deposit that it was unable to recover were deductible for income tax purposes.

The Commissioner denied those deductions on the basis that AAA's business had ceased on 24 July 2008 and any expenditure after that date had no nexus with the income-earning activities of the business.

The Authority found all expenditure in question after 24 July 2008 was not deductible and AAA appealed to the High Court.

Decision

The High Court dismissed the appeal on all grounds.

Justice Gendall began by referring to s DA 1 of the Income Tax Act 2007 ("the Act") and relevant case law (*Commissioner of Inland Revenue v Banks* [1978] 2 NZLR 472

(CA); *Buckley & Young v Commissioner of Inland Revenue* [1978] 2 NZLR 485 (CA)) on deductibility and noted that for AAA to be able to rely on s DA 1 it must establish the three essential elements of deductibility:

1. the expenditure must be incurred by AAA (there was no contest that the expenditure in question was incurred by AAA);
2. there must be a sufficient relationship or nexus between the expenditure and the income-earning process; and
3. none of the general limitations set out in s DA 2 of the Act must apply.

The timing issue and the nexus issue

Justice Gendall first considered what the business of AAA was. He referred to s YA 1 of the Act which defines "business" and *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101 (CA) in which Justice Richardson articulated a two-stage inquiry, consisting of, first, the nature of the business activity and, second, the intention of the taxpayer. His Honour rejected AAA's submission that it was established "to undertake business-like activities" and concluded that the business of AAA was solely limited to the development of the Land.

Justice Gendall then looked at when that business ceased. His Honour agreed with the Authority's finding that the business of AAA ceased from 24 July 2008 when AAA no longer had any profit-making intention. The property development venture was abandoned on 24 July 2008 and later activities of AAA were directed towards damage control and the recovery of expenditure.

On the nexus issue, Justice Gendall agreed with the Authority's finding that there was no nexus between the disputed expenditure and AAA's business or income-earning process. His Honour found that the deposits paid under the purchase agreement were effectively refunded to AAA who then agreed to pay the equivalent of one half of the deposit and costs to the vendor. This payment was made purely as a litigation settlement after the business had ceased and, therefore, there could not be any enduring benefit to the business associated with this expenditure. The legal, accounting and other related costs incurred by AAA post-July 2008 were simply the costs of AAA's actions in attempting to extricate itself from the onerous contract represented by the purchase agreement.

The breadth of business issue

This was a new argument raised by AAA on appeal and concerned the question of whether the nature of AAA's business was wider than the property development for which it was formed.

Justice Gendall held, having pointed out the argument was not in AAA's statement of position or notice of claim and that no application had been made to amend the pleadings, that the Commissioner would be prejudiced if AAA were now permitted to bring this new argument on appeal. Despite this, for completeness, the Court considered the argument briefly. AAA contended that as a constitution was not required by the Companies Act 1993, it was not constrained in any way as to the nature of the business activities it carried on and its business would include any undertaking for profit. The Court found that although this argument had a superficial attraction, in the circumstances it was inconsistent with the facts in the notice of claim and the agreed statement of facts and was "purely a concocted and unsupported last minute afterthought" with no merit. Leave was not granted to bring this new argument as it would be prejudicial to the Commissioner and inconsistent with the facts before the Authority and the High Court and agreed for the purpose of these proceedings.

The interest in land issue

AAA argued that even if its business did cease on 24 July 2008 and even if there was no nexus with an income-earning process, the expenses are still deductible because they are part of the costs of revenue account property, being the equitable interest in the Land that AAA acquired in 2006 when it entered into the purchase agreement.

Justice Gendall referred to s YA 1 of the Act, which provides that a property developer's land is revenue account property, and s DB 23, which allows deductions for expenditure incurred as the cost of revenue account property. His Honour noted that s DB 23(3) of the Act requires that the general permission contained in s DA 1 of the Act must still be satisfied and the Authority was correct to find there was no sufficient nexus in this case.

"Land taxing" provisions

Justice Gendall then moved on to consider AAA's alternative submissions on "land taxing" provisions—ss CB 6, CB 7, CB 9 and CB 10 of the Act.

AAA argued that because the income from disposing of the Land (the equitable interest) would be taxable under s CB 6 of the Act, then all expenses incurred in relation to the equitable interest of the Land should be deductible. The same analysis would apply if the amount derived from the disposal of the Land were taxable under ss CB 7, 9 or 10.

Putting to one side whether these sections could be raised because of the application of s 138G of the Tax Administration Act 1994 and the relevance of them given this is not an assessability case but a deductibility case, the Court considered that, regardless of which "land taxing" provision AAA attempted to rely on, the question will always be whether the general permission in s DA 1 has been satisfied. Section CB 6 does not apply here as no income was derived from disposing of the Land, there was no evidence that AAA intended to dispose of the equitable estate and even if s CB 6 applied, then pursuant to s DB 23(3) the general permission in s DA 1 of the Act would still need to be satisfied for the expenses to be deductible.

The Court also referred to AAA's argument that as a result of the settlement entered into with the vendor, AAA gave up its equitable interest in the Land and derived "income" for doing so. His Honour held that the "land" disposed of only ever consisted of an equitable interest, which AAA never had the requisite intention on acquisition to dispose of. As the vendor had succeeded before Clifford J that AAA was in breach of the purchase agreement, AAA no longer had any right to sue for specific performance to obtain legal title and AAA's interest related simply to a claim to the balance of the deposit.

AAA argued the settlement agreement between AAA and the vendor was, itself, a sale and purchase agreement. However, the plain wording of the settlement agreement was that it was in full and final settlement, first of the civil proceedings and, second, of all matters arising out of the purchase agreement. AAA's earlier equitable interest in the Land was contingent on full payment of the purchase price (which AAA clearly was not intending to pay nor able to pay). Therefore, it was not possible to construe the settlement agreement as including any disposition of an equitable interest in land.

The Court also noted that if AAA claimed that one of the land taxing provisions applied, then it should have returned the income in its 2011 return following the settlement. It did not and clearly the arguments AAA was endeavouring to advance were inconsistent.

The penalty issue

Justice Gendall held that the Authority did not err in taking the position it did to hold the 20% shortfall penalty under s 141B of the Tax Administration Act 1994 for taking an "unacceptable tax position" applied. Viewed objectively, the tax position taken by AAA did not meet the standard of being about as likely as not to be correct.

The Court dismissed the appeal.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

Legal and Technical Services also contribute to the "Your opportunity to comment" section.

Policy and Strategy

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

Litigation Management

Litigation Management manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

GET YOUR TAX INFORMATION BULLETIN ONLINE

The *Tax Information Bulletin (TIB)* is available online as a PDF at **www.ird.govt.nz** (search keywords: Tax Information Bulletin). You can subscribe to receive an email alert when each issue is published. Simply go to **www.ird.govt.nz/aboutir/newsletters/tib** and complete the subscription form.

An index to the TIB is also available at **www.ird.govt.nz/technical-tax/tib** (scroll down the page to "Volume indexes"). This is updated about twice a year.

Our website has other Inland Revenue information you may find useful, including draft binding rulings and interpretation statements.

New Zealand Government