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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

IN SUMMARY

Binding rulings

Product ruling BR Prd 15/01: Chorus Limited 4

The Arrangement is the establishment of a long-term incentive plan for senior executives of Chorus New Zealand Limited. Under the plan, amounts will be lent to the executives to enable them to acquire shares in Chorus Limited. The shares will be held on trust during a restrictive period, and will vest at the end of the restrictive period subject to certain performance criteria being satisfied. This ruling sets out the taxation consequences for the senior executives.

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QB 15/02: Income tax – Major development or division – What is "significant expenditure" for section CB 13 purposes? 20

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This statement sets out the Commissioner's operational position on the inclusion of expenditure on non-physical development work for s CB 13 purposes.

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QB 15/04: Income tax – Whether it is possible that the disposal of land that is part of an undertaking or scheme involving development or division will not give rise to income, even if no exclusion applies 37

This QWBA considers whether it is possible that the disposal of land that is part of an undertaking or scheme involving development or division will not give rise to income under s CB 12 or s CB 13, even if none of the statutory exclusions apply.

The QWBA concludes that if an undertaking or scheme involving development or division has been carried on (and meets the other criteria in s CB 12 or s CB 13) the proceeds on disposal of all of the land will be taxable under the relevant provision unless an exclusion applies. However, the Commissioner will accept that s CB 12 or s CB 13 does not apply to the disposal of any given part of the land if the taxpayer can provide satisfactory evidence that the undertaking or scheme was not carried on with a view to the disposal of that land.

New legislation

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Use-of-money interest rates change

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Interpretation of section 113: The Commissioner's ability to correct assessments 54

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This was an appeal from the decision of the Taxation Review Authority that found advisory services supplied by the appellant to overseas operators were chargeable with tax at the standard rate under s 8(1) of the Goods and Services Tax Act 1985. The appeal was dismissed.

No jurisdiction to determine proceeding where disputes procedure not completed 57

This was a decision of the Taxation Review Authority ("TRA") striking out the disputant's Notice of Claim on the grounds that the disputes procedure under Part 4A of the Tax Administration Act 1994 had not been completed. Therefore, the TRA lacked jurisdiction to hear and determine the proceeding.

Court of Appeal upholds High Court's decision granting Commissioner's transfer application 59

The Court of Appeal upheld the High Court's decision granting the Commissioner of Inland Revenue's application to transfer the challenge proceeding filed by Kensington Developments Limited's (in receivership) in the Taxation Review Authority to the High Court.

Legal decisions – case notes (continued)

Commissioner successful in associating two companies under section 2a(1) of the Goods and Services Tax Act 1985 **61**

The Taxation Review Authority ("TRA") held that the disputant and the vendor in a secondhand property transaction were associated persons under s 2A(1)(a)(i) of the Goods and Services Tax Act 1985. In the alternative, the TRA found the disputant had entered into a tax avoidance arrangement that was void as against the Commissioner of Inland Revenue under s 76.

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 15/01: CHORUS LIMITED

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Chorus Limited.

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CA 1, CE 1, CX 2, CX 10, CX 35, EW 3, EW 6, EW 31, GA 1, HC 6, and HC 7 and subpart CE.

The Arrangement to which this Ruling applies

The Arrangement is the establishment of a long-term incentive plan (Plan) for senior executives of Chorus New Zealand Limited (CNZL).

The following draft documents (in the form as provided to Inland Revenue on 23 May 2014) constitute part of the Arrangement:

- letter of invitation from Chorus Limited (Chorus) to employees of CNZL (Invitation Letter);
- Chorus long term incentive plan rules (Rules);
- Chorus long term incentive plan trust deed (Trust Deed) to be entered into between Chorus and Chorus LTI Trustee Limited (Trustee) acting as trustee of the Plan;
- Chorus long term incentive plan loan agreement (Loan Agreement) to be entered into between the participant and CNZL; and
- Chorus long term incentive plan put option deed to be entered into between Chorus and Trustee.

Broadly, the Arrangement operates as follows:

- CNZL will advance an interest free loan to Trustee as agent for, and at the request of, the employee. Trustee will use this loan to acquire shares in Chorus on behalf of the employee.
- The shares will be held on trust during a restrictive period. In respect of shares held on behalf of an employee:
  - distributions are applied in partial repayment of the employee's loan; and
  - the employee is able to direct Trustee how to vote.
- At the end of the restrictive period, the employee's ability to receive legal title to the shares will depend on whether vesting criteria are met.
  - Where the vesting criteria are **met** legal title will vest in the employee. In addition, the employee will receive a bonus equal to the grossed up original loan amount. The bonus (or part thereof, depending on the outstanding loan balance) is used to fully repay the employee's loan.
  - Where the vesting criteria are **failed** legal title will not vest in the employee. The employee will not receive a bonus. The loan becomes repayable in 20 days. The employee and Trustee have put and call options (respectively) to require Trustee to purchase and the employee to sell (respectively) the employee's beneficial interest in the shares to Trustee for the outstanding loan amount.

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

Objectives of the Plan

1. The primary objective of the Chorus Group in establishing the Plan is to encourage executives to become shareholders in Chorus, thus aligning their interests with those of other shareholders. Clause 2 of the Rules states that the objectives of the Plan are to:
   - reward and retain key employees;
   - drive longer-term performance and alignment of incentives of participants with the interests of Chorus' shareholders; and
   - encourage longer term decision-making.

Invitation

2. The Invitation Letter will be sent to certain employees of CNZL who are tax resident in New Zealand (potential Participants). The Invitation Letter details

the terms of the proposed grant, including a loan amount offered to the Participant that must be used to acquire shares in Chorus, the Plan Shares being held in trust for a restrictive period, a target cash bonus amount and performance hurdles. The Invitation Letter also specifies that the grant is subject to the Rules, Trust Deed and Loan Agreement.

3. The potential Participant may accept the grant by signing and returning the acceptance form attached to the Invitation Letter within a prescribed timeframe. In accepting the grant, the Participant acknowledges that they are bound by the Plan Rules, and that such acknowledgement is also for the benefit of CNZL and Trustee, and is intended to be enforceable by CNZL and Trustee.
4. CNZL is a wholly owned subsidiary of Chorus. The Participants will not be associated with Chorus or CNZL for the purpose of the Act.

Terms of loan

5. On acceptance of the grant, CNZL will advance an interest free loan to Trustee as agent for, and at the request of, the Participant (cl 2.1 of the Loan Agreement and cls 6.1, 6.3(a) and 6.3(b) of the Rules).
6. Trustee will be bound to use the loan amount to purchase or subscribe for new or existing ordinary shares in Chorus on behalf of the Participant (the Plan Shares) (cl 2.1(a) of the Loan Agreement and cls 5.2(b) and 6.2 of the Rules).
7. The loan will be limited recourse; that is, the recourse of CNZL (the lender) will be limited to the Plan Shares acquired with the proceeds of the loan (cl 2.1(d) of the Loan Agreement and cl 6.3(d) of the Rules). The Participant will have no liability in respect of the loan other than to the extent of their interest in the Plan Shares.
8. The loan will be repayable on the loan repayment date and otherwise in accordance with the Rules (cl 2.1(b) of the Loan Agreement). Except as otherwise provided in the Rules, a Participant may not prepay the loan balance (cls 2.1(b) and 2.1(c) of the Loan Agreement and cl 6.3(c) of the Rules). The Rules provide for repayment of the loan as follows:
    - The loan repayment date is the date that is 20 business days after the vesting date for legal title to the Plan Shares. The vesting date is set out in the Invitation Letter and is the date on which the performance hurdles are measured, currently set at three years from the commencement date (cl 16.9 of the Rules and the Invitation Letter).
    - A Participant must apply dividends (after deduction of any tax) to which the Participant is entitled in respect of that Participant's Plan Shares (as set out below) to partially repay the relevant Participant's loan amount, and the Participant instructs Trustee to do so (cl 6.4 of the Rules).
    - To the extent performance hurdles are achieved on the vesting date and the Participant is eligible to have legal title to the Plan Shares vested and a cash bonus, the Participant authorises CNZL to apply the after-tax bonus towards repayment of the loan balance (cls 10.1 and 10.3 of the Rules). Clause 10.4 of the Rules specifies that the Participant must repay the loan balance in respect of such Plan Shares on the loan repayment date in this manner.
    - To the extent hurdles are not met and the Participant is not eligible to have legal title to the Plan Shares vested, cl 10.4(b) of the Rules provides that cls 11 and 12 will apply. Clauses 11 and 12 each relate to call and put options (discussed further below). On Trustee's exercising of the call or the Participant's exercising of the put, the Participant must transfer its beneficial interest in the relevant Plan Shares to the Trustee for an amount equal to the outstanding loan balance, which shall be settled by the transfer of the loan balance from the Participant to Trustee by way of novation of the Loan Agreement (cls 11.2, 11.3(c), 12.2 and 12.3(c) of the Rules).

Acquisition and holding of Plan Shares

9. Trustee will acquire the Plan Shares either on-market or, if the Plan Shares are issued by Chorus or transferred from unallocated shares, at the volume weighted average price of Chorus shares on the NZX for the 10 trading day period before such issue or transfer (cl 7.2 of the Rules). No agreement to subscribe or purchase will be entered into by the Trustee before the relevant purchase, subscription or allocation of Plan Shares.
10. Trustee will hold the Plan Shares as trustee on behalf of the Participant pursuant to the Rules and the Trust Deed. On the vesting date, legal title to any Plan Shares the Trustee holds for a Participant will become eligible for vesting (cl 8.1 of the Rules). Trustee must maintain an account for each Participant detailing the number of Plan Shares and the loan balance (cl 8.2 of the Rules).
11. In respect of the Plan Shares, each Participant will be entitled to:
    - receive notices issued to shareholders by Chorus (cl 8.3(a) of the Rules);
    - exercise voting rights via instructing Trustee (cl 8.4 of the Rules); and

BINDING RULINGS

- receive any distributions (cl 8.3(b) of the Rules); such distributions must be applied to reduce the relevant Participant's loan balance while Trustee holds legal title to that Participant's Plan Shares.

12. Except as otherwise specified in the Plan, Plan Shares are not transferrable while the Trustee holds them. No Participant may grant security over that Participant's interest in any Plan Shares (cl 8.5 of the Rules).
13. Three adjustments are provided for in cl 13 of the Rules:
    - If, before vesting, Chorus confers on shareholders the rights to acquire shares or other benefits or assets, Chorus's board may offer further shares to Trustee as agent for the Participants so that Participants receive a benefit that reflects the value of the distribution rights to ordinary shareholders.
    - If, before vesting, Chorus, pursuant to a bonus issue, issues ordinary shares to shareholders in a manner that maintains the existing relative voting and distribution rights of all holders of ordinary shares, a Participant will be entitled on vesting to receive additional shares as if the Participant's Plan Shares had participated in the bonus issue.
    - If, before vesting, there is a reconstruction of the shares of Chorus, the Board may effect a similar reconstruction in relation to the Plan Shares held by Trustee for that Participant to ensure Participants are no better or worse off as a result of the reconstruction.
14. Plan Shares will be held by Trustee on behalf of the Participant pursuant to the Trust Deed. This will essentially be until legal title vests in the Participant following the vesting date or Trustee purchases the beneficial interest in the Shares. The trust will be a "complying trust", as defined in s HC 10.
15. If Trustee purchases the beneficial interest in any Plan Shares, Trustee will:
    - retain them for future Plan issues (while the shares are unallocated, Trustee will not exercise any voting rights in respect of such shares and will waive rights and entitlements to any dividends on such shares in accordance with cl 2.4 of the Trust Deed); or
    - sell them in the market and use the proceeds to settle the loan (which Trustee rather than the Participant will at that time owe to CNZL); or
    - exercise a put option to sell the Plan Shares back to Chorus for consideration equal to the loan balance outstanding, which Trustee can then use to settle the loan balance.
16. If Trustee has any surplus funds on the winding up of the Trust, whether by reason of any sale of Plan Shares at a price greater than the price paid by Trustee or otherwise, Trustee may distribute such funds as Trustee so wishes, provided no funds shall be distributed to Chorus (cl 5.2 of the Trust Deed).

Performance hurdles and vesting

17. The provisional hurdles are:
    - Tranche 1 – Chorus's total shareholder returns (TSR) from commencement of the Plan until the restrictive period ends must be greater than the 50th percentile TSR of NZX50 companies. If this hurdle is met, legal title in the shares will transfer to participants on a straight-line basis, from 50% transfer at the 50th percentile to l00% transfer, if the TSR is equal to the 75% percentile.
    - Tranche 2 – Chorus's TSR must be 10.4% or greater per year for legal title in all shares to be transferred.
18. The performance hurdles will be finalised around the time of the issue of the Invitation Letter to ensure the hurdles are appropriate at that time. The hurdles will be set at a level that is intended to push the executives to perform while being achievable and not unrealistic.

If the performance hurdles are achieved

19. Provided the Participant remains employed at the end of the restrictive period (cl 9.2 of the Rules) and to the extent performance conditions are met, Chorus will procure that a cash bonus equal to the grossed up value of the original loan is paid by CNZL to the Participant in respect of each Tranche (Invitation Letter and cls 7.1 and 10.1 of the Rules).
20. Where Chorus is required to procure the bonus for the Participant in accordance with the Plan, CNZL will pay the Participant the bonus pursuant to the employment contract entered into between CNZL and the relevant Participant.
21. The after-tax amount of the bonus will be paid to Trustee and applied to repay the loan balance, regardless of Chorus's share price at that time (cl 10.1 of the Rules). Any excess amount of bonus will be paid directly to the Participant. An excess will arise if dividends have previously been derived by the Participant on the Plan Shares and used, in compliance with the Rules, to partially repay the loan.
22. Trustee will transfer legal title to the Plan Shares to the Participant on repayment of the loan (cls 10.3 and 10.4 of the Rules).

If the performance hurdles are not met

23. To the extent performance conditions are not met, no or a reduced cash bonus will be paid (ie, vesting is proposed to be progressive in relation to Tranche 1) (cl 10.2 of the Rules).
24. Clauses 11.1 and 12.1 of the Rules provide that Trustee will grant a put option to each Participant in respect of each Participant's beneficial interest in the Plan Shares in consideration for the grant of a call option by each Participant to Trustee in respect of each Participant's beneficial interest in the Plan Shares. The options are effectively exercisable where vesting criteria are not met.
25. Trustee may exercise a call option requiring the Participant to sell their beneficial interest in the Plan Shares to Trustee for an amount equal to the loan balance. The purchase price under the call option will be settled by the transfer of the loan balance from the Participant to Trustee by way of novation of the Loan Agreement (cls 11.1 and 11.2 of the Rules). Therefore, after novation, the loan will be owed by Trustee to CNZL.
26. Failing exercise of the call option, the Participant can exercise an equal and opposite put option requiring Trustee to purchase the beneficial interest in the Plan Shares from the Participant on the same basis (cls 12.1 and 12.2 of the Rules). The put option can be exercised only in limited circumstances where the performance hurdles are not met and the call option has not been exercised (cl 12.3 of the Rules). The Participants cannot exercise the put option if the hurdles are met but the share price has fallen.
27. Because the consideration for the transfer of the Participant's beneficial interest in Plan Shares under the call and put options is an amount equal to the loan balance, it is unlikely one or other will not be exercised if the performance hurdles are not met. If, for whatever reason, no option is exercised, the loan will become due on the loan repayment date regardless. Accordingly, the Participant will be required to repay the loan or CNZL will be able to take legal steps to execute against the shares.

Cessation of employment

28. If the Participant ceases to be employed as a result of an involuntary event (eg, death, redundancy or ill health) before the restrictive period ends, the vesting date will be brought forward and an apportionment made to determine the number of shares eligible for immediate transfer of legal title (cl 9.1 of the Rules). If the Participant ceases to be employed for any other reasons or otherwise elects to cease participating in the Plan, then the Participant will not be eligible for a cash bonus and the Plan Shares will be subject to cls 11 and 12 of the Rules (ie, as if the performance hurdles had not been met).

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The value of the Plan Shares on the date Trustee acquires them on behalf of the relevant Participant will equal the price payable by the Participant for those Plan Shares.

b) The final executed documents will not be materially different to the draft documents provided to Inland Revenue on 23 May 2014.

How the Taxation Laws apply to the Arrangement

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

a) Trustee's purchase of Plan Shares on behalf of the Participants will not give rise to any income to the Participants under subpart CE.

b) Cash bonuses CNZL pays to eligible Participants will be income of the Participant under s CE 1(1)(a).

c) The transfer of legal title in the Plan Shares to Participants will not result in the Participants deriving:
   - income under ordinary concepts for the purpose of s CA 1(2);
   - income in connection with their employment under s CE 1(1); or
   - beneficiary income under s HC 6.

d) Where Trustee derives Chorus distributions on Plan Shares that are held on behalf of Participants, such distributions will constitute "beneficiary income" of the relevant Participant in accordance with s HC 6 and not "trustee income" in accordance with s HC 7.

e) When the Participant transfers their beneficial interest in Plan Shares to Trustee following exercise of the call or put option:
   - the Participant will not derive any income under s CE 1; and
   - no fringe benefit will arise under s CX 2.

f) The Plan, including the share acquisition, loan, bonus and options, but excluding any market purchase of shares by Trustee, is a "financial arrangement" as defined in s EW 3.

g) The Participants must use Determination S33 to determine amounts solely attributable to the Shares, Put Options, Call Options and Employment Contracts (as defined in Determination S33) for the purposes of s EW 6(2).

h) If a put or call option is exercised in accordance with the Plan, the base price adjustment calculated in accordance with s EW 31(5) on novation of the Loan Agreement will be nil for the Participant, provided Determination S33 is applied.

i) Sections BG 1 and GA 1 do not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 4 February 2015 and ending on 31 December 2018.

This Ruling is signed by me on the 4th day of February 2015.

Howard Davis

Director (Taxpayer Rulings)

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 DEP91: GAS DETECTORS – HAND-HELD AND FIXED

Note to Determination DEP91

The Commissioner sets general depreciation rates for gas detectors that are battery operated hand-held types or wired/fixed to plant and machinery.

Gas detectors are used by many industries that use gas or work in enclosed spaces. Although the hand-held type of gas detector may come within the existing asset class for "Instruments hand-held" under the "Scientific and laboratory equipment (excluding equipment used in a medical laboratory)" asset category, many business users may not identify the asset class of "instruments hand-held" as applicable to hand-held gas detectors used in other industries. Consequently, this determination adds two new gas detector asset classes to the "Factory and other sundries", "Refrigeration", "Scientific and laboratory equipment (excluding equipment used in a medical laboratory)" and "Water and effluent treatment (where not industry specified)" asset categories, to provide more certainty for taxpayers when considering the depreciation treatment of gas detectors.

DETERMINATION DEP91: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 91

1. Application

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

This determination applies from the 2015 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 "Factory and other sundries", "Refrigeration", "Scientific and laboratory equipment (excluding equipment used in a medical laboratory)" and "Water and effluent treatment (where not industry specified)" asset categories, new asset classes, estimated useful lives, and diminishing value and straight line depreciation rates as listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Gas detectors (hand-held)	5	40	30
Gas detectors (fixed)	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 16th day of March 2015.

Rob Wells

LTS Manager, Technical Standards

GENERAL DEPRECIATION DETERMINATION DEP92: WOOL/SHEARING SHEDS

Note to Determination DEP92

The Commissioner sets a specific general depreciation rate for wool/shearing sheds by adding new asset class to the "Agricultural, horticulture and aquaculture" industry category and the "Buildings and structures" asset category.

The introduction of a specific asset class is to clarify the treatment of wool/shearing sheds for depreciation purposes. There is concern that since the changes to the depreciation rules announced in the May 2010 Budget, that there is no specific asset class for wool/shearing sheds has seen taxpayers treating these assets inconsistently for depreciation purposes. Some taxpayers have categorised wool/shearing shed buildings as "barns" and continued to claim depreciation on the basis these buildings are "barns" with an estimated useful life of 20 years.

Prior to the May 2010 Budget, the generally accepted view has been (although not published) that wool/shearing sheds are buildings with timber and/or steel framing, with an estimated useful life of 50 years.

Wool/shearing shed design is specialised, usually incorporating covered holding pens (sheep must be dry and have evacuated bowels for shearing), filling and catching pens, a raised shearing board (where shearing takes place), release pens and counting out pens. Wool rooms (where the wool is sorted and baled) are also included. Pens have grated floors so that the sheep droppings fall through and do not contaminate the wool. Wool/shearing sheds experience only seasonal use (the main shearing period) although they may be used for crutching (shearing the crutch area to prevent fly-strike) several times during the warmer months.

It is suggested that taxpayers who have incorrectly claimed depreciation for wool/shearing sheds on the basis of those purpose-built buildings are "barns" was never a legitimate option, and they may like to make a voluntary disclosure to correct their tax position.

The application date for the specific asset class for "wool/shearing sheds", will be from the 2015 and subsequent income years. Prior to the 2015 income year, affected taxpayers should have been using the "buildings with steel or steel and timber framing" asset default class for wool/shearing sheds, with an estimated useful life of 50 years.

DETERMINATION DEP92: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 92

1. Application

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

This determination applies from the 2015 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 "Agricultural, horticulture and aquaculture" industry category and the "Buildings and structures" asset category, a new asset class, estimated useful life, and diminishing value and straight line depreciation rates as listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Wool/shearing shed	50	0	0

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 19th day of March 2015.

Rob Wells

LTS Manager, Technical Standards

PROVISIONAL DEPRECIATION DETERMINATION PROV26: HYDROELECTRIC POWERHOUSES

Note to Determination PROV26

The Commissioner of Inland Revenue has set a provisional depreciation rate for hydroelectric powerhouses by adding a new asset class to the "Power generation and electrical reticulation" industry category.

A hydroelectric powerhouse is integral to the function of a hydroelectric power scheme's purpose of generating hydroelectricity.

Hydroelectric powerhouses have diverse outward appearances. However, there is a relatively consistent internal design, as follows:

- In most cases, there is an above-ground component to hydroelectric powerhouses which are covered with a form of exterior weather-proofing. In other cases, the hydroelectric powerhouses are built entirely below-ground.
- Hydroelectric powerhouses are generally multi-levelled structures with access galleries in order to gain access to the turbines and generators.
- Reinforced foundations and walls are required in order to carry the water flows through the structure, contain and withstand the forces arising from the operating the turbines and generators, and carry the gantry cranes which are used to remove the turbines and generators for maintenance and/or replacement.

To the extent that the components situated within powerhouses are separate depreciable property they are to be depreciated in line with the general economic rate provided in the "Power Generation and electrical Reticulation Systems" industry category. For example, "Turbines (water)" at a rate of 10% DV, based on an estimated useful life of 10 years.

The provisional depreciation rate for hydroelectric powerhouses does not apply to powerhouses used as part of other forms of electricity generation.

DETERMINATION: TAX DEPRECIATION RATES PROVISIONAL DETERMINATION NUMBER 26

1. Application

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

This determination applies from the 2012 and subsequent income years.

2. Determination

Pursuant to section 91AAG of the Tax Administration Act 1994, the provisional determination will apply to the kind of items of depreciable property listed in the table below by adding into the "Power generation and electrical reticulation" industry category, a new asset class, estimated useful life (EUL), and diminishing value (DV) and straight line (SL) depreciation rates, as listed below:

Asset class	EUL (years)	DV depn rate (%)	DV + 20% loading	SL depn rate (%)	SL + 20% loading
Hydroelectric powerhouses	100	2	2.4	1.5	1.8

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 25th day of March 2015.

Rob Wells

LTS Manager, Technical Standards

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS (FOR THE 12 MONTHS ENDING 31 MARCH 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 12 months ending 31 March 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 12 months ending 31 March 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 12 months ending 31 March 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 12 months ending 31 March 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 12 months ending 31 March 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 (section 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 12 months ending 31 March 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 (section 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 6 September 2014. Its opening market value on 1 October 2014 or its closing market value on 30 September 2014 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 ÷ 34.9056 = $10,027.04

(In this example, the rate selected is the month-end rate for September 2014 for PHP. Refer to the table "Currency rates 12 months ending 31 March 2015 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 31 December 2014. Attributed CFC income for the period 1 January 2014 to 31 December 2014 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 6.4795 = $30,866.58

(In this example, the rate selected is the rolling 12-month average rate for December 2014 for HKD. Refer to the table "Currency rates 12 months ending 31 March 2015 – rolling 12-month average".)

Example 3

A resident individual with a 31 October 2014 accounting period acquired a FIF interest in a Japanese company on 1 November 2013 for 10,500,000 yen. The interest is sold in October 2014 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 ÷ 86.6823 = $121,132.00

JPY 10,000,000 ÷ 86.6823 = $115,363.81

(In this example, the rolling 12-month rate for October 2014 for JPY has been applied to both calculations. Refer to the table "Currency rates 12 months ending 31 March 2015 – rolling 12-month average".)

Example 4

A CFC resident in Singapore was formed on 19 April 2014 and has a balance date of 30 September 2014. During the period 1 May 2014 to 30 September 2014, 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 2014:

   1.0824 + 1.0838 + 1.0906 + 1.0569 + 1.0334 = 5.3471

   5.3471 ÷ 5 = 1.06942

2. Round exchange rate to four decimal places: 1.0694

3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 1.0694 = $467,551.90

(In this example, the rates are from the table "Currency rates 12 months ending 31 March 2015 – mid-month actual", from May to September 2014 inclusive for SGD.)

LEGISLATION AND DETERMINATIONS

Currency rates 12 months ending 31 March 2015 – rolling month actual

Currency	Code	15/04/14	15/05/14	15/06/14	15/07/14	15/08/14	15/09/14	15/10/14	15/11/14	15/12/14	15/01/15	15/02/15	15/03/15
Australia Dollar	AUD	0.8931	0.9007	0.9074	0.9139	0.9162	0.9184	0.9205	0.9217	0.9234	0.9248	0.9276	0.9289
Bahrain Dinar	BHD	0.3116	0.3129	0.3148	0.3178	0.3191	0.3193	0.3180	0.3167	0.3150	0.3134	0.3106	0.3068
Britain Pound	GBH	0.5154	0.5132	0.5131	0.5126	0.5120	0.5113	0.5092	0.5081	0.5072	0.5077	0.5064	0.5051
Canada Dollar	CAD	0.8736	0.8823	0.8924	0.9032	0.9109	0.9161	0.9185	0.9204	0.9230	0.9251	0.9259	0.9251
China Yuan	CNY	5.0553	5.0819	5.1194	5.1736	5.1976	5.2015	5.1827	5.1631	5.1439	5.1272	5.0932	5.0389
Denmark Kroner	DKK	4.5741	4.5692	4.5928	4.6228	4.6404	4.6523	4.6534	4.6612	4.6733	4.7088	4.7348	4.7878
Euporean Community Euro	EUR	0.6132	0.6124	0.6155	0.6196	0.6219	0.6236	0.6239	0.6250	0.6268	0.6318	0.6355	0.6426
Fiji Dollar	FJD	1.5339	1.5416	1.5518	1.5622	1.5661	1.5692	1.5693	1.5699	1.5688	1.5673	1.5639	1.5583
French Polynesia Franc	XPF	73.1675	73.0734	73.4489	73.9347	74.2226	74.4277	74.4707	74.6081	74.8172	75.4201	75.8505	76.7147
Hong Kong Dollar	HKD	6.4103	6.4356	6.4751	6.5365	6.5629	6.5656	6.5401	6.5128	6.4795	6.4461	6.3873	6.3096
India Rupee	INR	50.1763	50.7103	51.1397	51.6807	51.8547	51.7080	51.3998	51.0851	50.9015	50.6313	50.1609	49.6534
Indonesia Rupiah	IDR	9,142.9017	9,304.7083	9,493.6458	9,698.4908	9,822.5217	9,873.8358	9,909.4217	9,906.6033	9,895.5325	9,864.7367	9,832.0200	9,833.5850
Japan Yen	JPY	82.9540	83.2486	84.2967	85.2286	85.9152	86.4854	86.6823	87.3840	87.8833	88.1928	88.4773	88.6813
Korea Won	KOR	894.3283	891.7575	889.8309	891.9265	888.7215	885.8875	882.0029	880.6226	879.1284	875.2619	869.3581	862.8028
Kuwait Dinar	KWD	0.2341	0.2347	0.2361	0.2382	0.2391	0.2393	0.2387	0.2382	0.2376	0.2371	0.2358	0.2342
Malaysia Ringit	MYR	2.6566	2.6848	2.7081	2.7343	2.7364	2.7326	2.7257	2.7238	2.7272	2.7283	2.7193	2.7118
Norway Krone	NOK	4.9533	4.9804	5.0296	5.0889	5.1252	5.1590	5.1737	5.1941	5.2518	5.3196	5.3675	5.4448
Pakistan Rupee	PKR	84.7909	85.1383	85.6470	86.3830	86.5581	86.4384	85.8285	85.1085	84.1938	83.4455	82.4487	81.6055
Phillipines Peso	PHP	36.1443	36.4848	36.7730	37.1452	37.2808	37.3127	37.2229	37.1508	37.0020	36.7546	36.3785	35.9163
PNG Kina	PGK	1.9580	2.0088	2.0408	2.0793	2.1022	2.1144	2.1108	2.1098	2.1077	2.1075	2.0997	2.0831
Singapore Dollar	SGD	1.0391	1.0438	1.0502	1.0589	1.0616	1.0617	1.0596	1.0585	1.0570	1.0550	1.0515	1.0466
Solomon Islands Dollar*	SBD	0.1148	0.1151	0.1158	0.1166	0.1170	0.1169	0.1162	0.1155	0.1144	0.1135	0.1122	0.1102
South Africa Rand	ZAR	8.4347	8.5485	8.6528	8.7929	8.8700	8.9436	8.9835	9.0077	9.0579	9.0560	9.0249	9.0288
Sri Lanka Rupee	LKR	107.6250	108.3972	109.1694	110.1357	110.5297	110.4344	109.9575	109.4805	109.0233	108.5564	107.6498	106.5604
Sweden Krona	SEK	5.4009	5.4161	5.4651	5.5292	5.5747	5.6150	5.6373	5.6630	5.7033	5.7822	5.8567	5.9358

Currency	Code	15/04/14	15/05/14	15/06/14	15/07/14	15/08/14	15/09/14	15/10/14	15/11/14	15/12/14	15/01/15	15/02/15	15/03/15
Swiss Franc	CHF	0.7543	0.7522	0.7554	0.7592	0.7607	0.7614	0.7603	0.7599	0.7610	0.7526	0.7483	0.7477
Taiwan Dollar	TAI	24.7170	24.8338	24.9979	25.2511	25.3555	25.3973	25.3681	25.3365	25.3166	25.2882	25.1264	24.9081
Thailand Baht	THB	26.1331	26.4320	26.7181	27.0415	27.1930	27.2337	27.2072	27.1738	27.0948	26.9469	26.7179	26.4353
Tonga Pa'anga*	TOP	1.4837	1.4966	1.5083	1.5214	1.5289	1.5352	1.5385	1.5392	1.5375	1.5344	1.5291	1.5205
United States Dollar	USD	0.8264	0.8297	0.8349	0.8429	0.8463	0.8467	0.8434	0.8398	0.8355	0.8312	0.8237	0.8136
Vanuatu Vatu	VUV	79.3889	79.5989	80.1728	80.8984	81.0571	81.0050	80.8984	80.7950	80.6933	80.6933	80.3731	79.7806
West Samoan Tala*	WST	1.9088	1.9140	1.9174	1.9407	1.9345	1.9245	1.9273	1.9287	1.9251	1.9116	1.9055	1.8843

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 12 months ending 31 March 2015 – mid-month actual

Currency	Code	15/04/14	15/05/14	15/06/14	15/07/14	15/08/14	15/09/14	15/10/14	15/11/14	15/12/14	15/01/15	15/02/15	15/03/15
Australia Dollar	AUD	0.9234	0.9238	0.9223	0.9358	0.9107	0.9056	0.9047	0.9038	0.9432	0.9522	0.9597	0.9614
Bahrain Dinar	BHD	0.3258	0.3258	0.3268	0.3306	0.3200	0.3083	0.3011	0.2982	0.2920	0.2950	0.2814	0.2768
Britain Pound	GBH	0.5166	0.5148	0.5111	0.5115	0.5083	0.5036	0.4986	0.5047	0.4953	0.5153	0.4841	0.4978
Canada Dollar	CAD	0.9490	0.9409	0.9405	0.9433	0.9246	0.9038	0.8990	0.8927	0.9040	0.9361	0.9288	0.9383
China Yuan	CNY	5.3771	5.3845	5.3840	5.4429	5.2234	5.0218	4.8922	4.8500	4.7935	4.8407	4.6603	4.5958
Denmark Kroner	DKK	4.6708	4.7062	4.7773	4.8187	4.7215	4.7040	4.6328	4.7021	4.6332	4.9994	4.8712	5.2159
Euporean Community Euro	EUR	0.6256	0.6305	0.6406	0.6461	0.6334	0.6318	0.6222	0.6315	0.6228	0.6726	0.6550	0.6992
Fiji Dollar	FJD	1.5803	1.5924	1.5936	1.6116	1.5691	1.5499	1.5321	1.5494	1.5319	1.5497	1.5214	1.5181
French Polynesia Franc	XPF	74.6865	75.2311	76.4640	77.1205	75.5956	75.3999	74.4211	75.3500	74.3201	80.3742	78.0244	83.5892
Hong Kong Dollar	HKD	6.7019	6.7001	6.7214	6.7953	6.5767	6.3375	6.1954	6.1343	6.0048	6.0663	5.7820	5.6993
India Rupee	INR	52.1310	51.3661	51.7090	52.9449	51.6762	49.9029	48.1316	48.5918	48.7895	48.2359	46.1859	46.1763
Indonesia Rupiah	IDR	9882.7000	9927.1300	10222.5800	10320.5600	9917.8900	9741.3100	9581.5400	9596.7600	9858.6800	9713.9900	9517.7200	9722.1600
Japan Yen	JPY	88.0850	87.7940	88.4140	89.1540	86.8510	87.6400	84.5980	91.9570	91.2470	90.8960	88.5480	88.9910
Korea Won	KOR	900.8240	889.4020	884.7852	900.8713	863.7851	848.9940	847.5643	870.7799	850.3255	841.6064	819.2041	835.4914
Kuwait Dinar	KWD	0.2431	0.2437	0.2448	0.2474	0.2404	0.2344	0.2301	0.2300	0.2260	0.2297	0.2204	0.2204
Malaysia Ringit	MYR	2.8055	2.7979	2.7893	2.8045	2.6784	2.6273	2.5685	2.6303	2.7117	2.7546	2.6607	2.7134
Norway Krone	NOK	5.1452	5.1432	5.1930	5.4446	5.2054	5.2274	5.2232	5.3386	5.7975	5.9312	5.6606	6.0272
Pakistan Rupee	PKR	83.3333	85.4701	85.4701	86.9565	84.7458	84.0336	81.9672	80.6452	77.5194	78.7402	75.7576	74.6269
Phillipines Peso	PHP	38.4575	37.8604	37.9504	38.3776	37.0934	36.0158	35.1496	35.3138	34.6491	34.5785	32.9390	32.6101
PNG Kina	PGK	2.3184	2.3688	2.1214	2.1479	2.0890	2.0196	2.0073	2.0317	1.9917	2.0202	1.9468	1.9347
Singapore Dollar	SGD	1.0824	1.0824	1.0838	1.0906	1.0569	1.0334	1.0160	1.0267	1.0168	1.0379	1.0105	1.0223
Solomon Islands Dollar*	SBD	0.1189	0.1184	0.1185	0.1207	0.1176	0.1116	0.1092	0.1070	0.1018	0.1048	0.0998	0.0945
South Africa Rand	ZAR	9.1264	8.9939	9.2571	9.3905	8.9920	8.9643	8.8457	8.7617	9.1067	9.0501	8.6984	9.1591
Sri Lanka Rupee	LKR	112.3596	112.3596	112.3596	113.6364	111.1111	106.3830	104.1667	104.1667	102.0408	103.0928	99.0099	98.0392
Sweden Krona	SEK	5.6811	5.6811	5.7621	5.9821	5.7994	5.8178	5.7148	5.8414	5.9209	6.3407	6.2823	6.4063

Currency	Code	15/04/14	15/05/14	15/06/14	15/07/14	15/08/14	15/09/14	15/10/14	15/11/14	15/12/14	15/01/15	15/02/15	15/03/15
Swiss Franc	CHF	0.7607	0.7701	0.7798	0.7853	0.7658	0.7647	0.7508	0.7584	0.7478	0.6565	0.6946	0.7377
Taiwan Dollar	TAI	26.0906	26.1008	26.0062	26.3302	25.4387	24.6552	24.2642	24.2992	24.2834	24.7588	23.3928	23.2772
Thailand Baht	THB	27.9399	28.1120	28.0492	28.1804	27.0618	26.3860	25.8979	25.9397	25.5425	25.6398	24.3056	24.1683
Tonga Pa'anga*	TOP	1.5719	1.5827	1.5559	1.5714	1.5494	1.5333	1.5258	1.4977	1.4781	1.4751	1.4588	1.4455
United States Dollar	USD	0.8643	0.8643	0.8664	0.8768	0.8485	0.8176	0.7987	0.7908	0.7745	0.7825	0.7457	0.7334
Vanuatu Vatu	VUV	81.3008	80.6452	82.6446	83.3333	80.6452	78.7402	79.3651	78.1250	77.5194	80.0000	78.1250	76.9231
West Samoan Tala*	WST	1.9155	1.9241	1.9160	2.0981	1.8764	1.8448	1.9112	1.8603	1.8262	1.8321	1.8188	1.7888

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 12 months ending 31 March 2015– month end

Currency	Code	30/04/14	31/05/14	30/06/14	31/07/14	31/08/14	30/09/14	31/10/14	30/11/14	31/12/14	31/01/15	28/02/15	31/03/15
Australia Dollar	AUD	0.9278	0.9126	0.9285	0.9145	0.8951	0.8927	0.8854	0.9219	0.9542	0.9335	0.9684	0.9824
Bahrain Dinar	BHD	0.3248	0.3205	0.3302	0.3205	0.3151	0.2944	0.2939	0.2956	0.2939	0.2737	0.2852	0.2816
Britain Pound	GBH	0.5107	0.5072	0.5120	0.5034	0.5037	0.4816	0.4871	0.5012	0.5004	0.4821	0.4901	0.5041
Canada Dollar	CAD	0.9446	0.9218	0.9345	0.9271	0.9096	0.8744	0.8775	0.8958	0.9061	0.9241	0.9465	0.9477
China Yuan	CNY	5.3941	5.3106	5.4340	5.2477	5.1396	4.7929	4.7637	4.8166	4.8366	4.5407	4.7424	4.6310
Denmark Kroner	DKK	4.6382	4.6524	4.7687	4.7331	4.7422	4.6019	4.6303	4.6869	4.7998	4.7821	5.0426	5.2009
Euporean Community Euro	EUR	0.6214	0.6235	0.6396	0.6348	0.6365	0.6182	0.6221	0.6302	0.6453	0.6429	0.6756	0.6960
Fiji Dollar	FJD	1.5921	1.5637	1.6057	1.5785	1.5492	1.5117	1.5179	1.5277	1.5509	1.4797	1.5430	1.5392
French Polynesia Franc	XPF	74.1179	74.4100	76.3285	75.7465	75.9102	73.7739	74.2311	75.2165	76.8321	76.6638	80.6653	82.8974
Hong Kong Dollar	HKD	6.6806	6.5879	6.7878	6.5878	6.4779	6.0630	6.0412	6.0815	6.0455	5.6269	5.8663	5.7910
India Rupee	INR	51.6389	50.1625	52.6042	51.4144	50.7197	47.8132	48.3064	48.7432	49.3675	44.9016	46.7680	46.7524
Indonesia Rupiah	IDR	9895.27	9915.52	10374.26	9830.26	9807.03	9460.30	9502.10	9565.76	9712.07	9210.69	9761.18	9752.52
Japan Yen	JPY	88.0770	86.4950	88.7410	87.3780	87.0400	85.6110	87.4830	93.0270	93.3790	85.2730	90.4850	89.7350
Korea Won	KOR	890.2261	868.0378	886.3065	877.7217	848.0726	826.5573	836.8932	872.7763	853.1499	800.9483	833.1806	828.3846
Kuwait Dinar	KWD	0.2422	0.2396	0.2466	0.2408	0.2380	0.2252	0.2261	0.2288	0.2286	0.2143	0.2242	0.2249
Malaysia Ringit	MYR	2.7949	2.7283	2.8049	2.7132	2.6441	2.5473	2.5866	2.6521	2.7421	2.6374	2.7208	2.7634
Norway Krone	NOK	5.1261	5.0765	5.3716	5.3431	5.1817	5.0163	5.2583	5.5139	5.8112	5.6117	5.8146	6.0222
Pakistan Rupee	PKR	84.7458	84.0336	86.2069	84.0336	85.4701	80.0000	80.0000	80.0000	78.7402	73.5294	76.9231	76.3359
Phillipines Peso	PHP	38.1535	37.1682	38.1353	36.9005	36.5698	34.9056	35.2959	35.2065	35.0726	32.0629	33.2752	33.3373
PNG Kina	PGK	2.3557	2.3328	2.1431	2.0846	2.0573	1.9411	1.9566	2.0119	2.0013	1.8873	1.9940	1.9737
Singapore Dollar	SGD	1.0803	1.0661	1.0917	1.0606	1.0441	0.9962	1.0016	1.0230	1.0337	0.9829	1.0306	1.0252
Solomon Islands Dollar*	SBD	6.2880	6.2604	6.3949	6.1355	6.0381	5.8101	5.6885	5.8135	5.9543	5.5091	5.7131	5.6822
South Africa Rand	ZAR	9.0673	8.9844	9.3166	9.1015	8.9161	8.8119	8.5917	8.6725	9.0241	8.4545	8.8211	9.0624
Sri Lanka Rupee	LKR	112.3596	111.1111	113.6364	111.1111	108.6957	102.0408	102.0408	103.0928	102.0408	96.1538	101.0101	99.0099
Sweden Krona	SEK	5.6030	5.6844	5.8532	5.8632	5.8445	5.6332	5.7566	5.8466	6.0871	6.0168	6.3057	6.4474

Currency	Code	30/04/14	31/05/14	30/06/14	31/07/14	31/08/14	30/09/14	31/10/14	30/11/14	31/12/14	31/01/15	28/02/15	31/03/15
Swiss Franc	CHF	0.7586	0.7610	0.7767	0.7725	0.7678	0.7457	0.7498	0.7569	0.7749	0.6674	0.7218	0.7264
Taiwan Dollar	TAI	26.0068	25.5374	26.1603	25.5399	24.9674	23.7550	23.7431	24.3191	24.6724	22.9802	23.7881	23.3474
Thailand Baht	THB	27.8855	27.9074	28.4106	27.3628	26.7101	25.3273	25.4065	25.7669	25.6596	23.7719	24.4796	24.3181
Tonga Pa'anga*	TOP	1.5655	1.5301	1.5701	1.5201	1.5064	1.4693	1.4470	1.4870	1.4787	1.4394	1.5021	1.4894
United States Dollar	USD	0.8617	0.8499	0.8758	0.8500	0.8362	0.7808	0.7789	0.7841	0.7797	0.7261	0.7564	0.7470
Vanuatu Vatu	VUV	81.9672	81.3008	83.3333	80.6452	79.3651	75.1880	76.9231	77.5194	80.0000	74.0741	78.7402	80.0000
West Samoan Tala*	WST	1.9098	1.8795	1.9281	1.8755	1.8492	1.7617	1.7816	1.8146	1.8884	1.7535	1.8449	1.7909

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

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 15/02: INCOME TAX – MAJOR DEVELOPMENT OR DIVISION – WHAT IS "SIGNIFICANT EXPENDITURE" FOR SECTION CB 13 PURPOSES?

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

This Question We've Been Asked is about s CB 13.

Question

1. What expenditure is taken into account for s CB 13 purposes, and when will such expenditure be regarded as "significant"?

Answer

2. Expenditure on the following **is** taken into account for s CB 13 purposes:
   - channelling, contouring, drainage, earthworks, kerbing, levelling and roading;
   - other physical developmental work that is customarily found in major projects involving development of land for commercial, industrial or residential purposes (for example, paving, retaining, sewage piping, power cabling, demolition and site clearing); and
   - other non-physical developmental work that is customarily found in major projects involving development of land for commercial, industrial or residential purposes (for example, preparation of zoning applications, the drawing of engineering plans and specifications, and the provision of estimates).
3. The following **is not** taken into account for s CB 13 purposes:
   - non-developmental work;
   - the value of a person's time, effort or use of their machinery or other equipment in undertaking the development work; and
   - future expenditure not yet incurred on the undertaking or scheme.
4. Whether expenditure on the undertaking or scheme is significant for s CB 13 purposes requires consideration of:
   - the amount of the expenditure in absolute terms;
   - the amount of the expenditure relative to the pre and post development value of the land; and
   - the context of the project.
5. Whether the total amount of relevant expenditure is "significant" for s CB 13 purposes will be a matter of fact and degree in the circumstances of any given case, bearing in mind that the focus of the provision is major projects.
6. This item qualifies IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5 in one respect. IG0010 is regarded as incorrect to the extent that it suggests that only physical work can be "development" work. On this point, see further from [23].

Explanation

7. An amount is income of a person under s CB 13 (provided the amount is not income under any of ss CB 6 to CB 12 and CB 14) if it is derived by them from disposing of land in circumstances where:
   - an undertaking or scheme (not necessarily in the nature of a business) is carried on by the person (or by someone for them);
   - the undertaking or scheme involves the development of the land or the division of the land into lots; and
   - the development or division work involves significant expenditure on channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.
8. There are a number of exclusions from s CB 13: the residential exclusions (s CB 17), the business exclusion (s CB 20), the farm land exclusion (s CB 21) and the investment exclusion (s CB 23). This item does not cover the application of the exclusions.
9. Normally a person is allowed a deduction for expenditure they incur as the cost of revenue account property (s DB 23). However, when a person derives income under s CB 13, s DB 27 allows a deduction for the value of the land at the time the undertaking or scheme commenced. As a result, when s CB 13 applies, the increase in the value of the land from the time the

undertaking or scheme is commenced until the land is disposed of is taxed.

10. The question we have been asked requires consideration of:

- what expenditure is taken into account for s CB 13 purposes; and
- when expenditure will be "significant" for s CB 13 purposes.

Legislation

11. Section CB 13 provides (relevantly) as follows:

> **CB 13 Disposal: amount from major development or division and not already in income**
>
> *Income*
>
> (1) An amount that a person derives from disposing of land is income of the person if—
>
> (a) the amount is not income under any of sections CB 6 to CB 12 and CB 14; and
>
> (b) the amount is derived in the following circumstances:
>
> (i) an undertaking or scheme, which is not necessarily in the nature of a business, is carried on; and
>
> (ii) the undertaking or scheme involves the development of the land or the division of the land into lots; and
>
> (iii) the person, or another person for them, carries on development or division work on or relating to the land; and
>
> (iv) **the development or division work involves significant expenditure on channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.**
>
> …
>
> [Emphasis added]

Application of the legislation

12. As can be seen, s CB 13(1)(b)(iv) is the relevant paragraph of the provision here. That paragraph requires that the development or division work involves significant expenditure on:

- channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or
- any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.

13. The following discussion considers the issue of **what expenditure** is taken into account for s CB 13 purposes, followed by the issue of **when expenditure will be "significant"** for s CB 13 purposes.

What expenditure is taken into account for s CB 13 purposes?

14. The first issue raised is what expenditure is taken into account for s CB 13 purposes. A number of sub-issues arise from this question, namely:

- Is the "any other amenity, service, or work …" category limited to things of the same type as the specifically listed works? If so, what things will be in that category?
- Is it only work found solely in major projects that is relevant, or is work that is found in both major and non-major projects included?
- Does the work have to be undertaken or provided in the context of an industrial, commercial or residential development?
- Is a person's time and the use of their own machinery taken into account?
- Is intended future expenditure on the undertaking or scheme taken into account?

These are considered in turn below.

Is the "any other amenity, service, or work …" category limited to things of the same type as the specifically listed works? If so, what things will be in that category?

15. As can be seen at [11], some specific works are referred to in s CB 13(1)(b)(iv)—channelling, contouring, drainage, earthworks, kerbing, levelling, roading. All of the works in this specific list involve physical development work on the land. However, the provision then includes the more general phrase "or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes". The first issue for consideration is what is included within that phrase.

16. The *ejusdem generis* principle of statutory interpretation may assist with this issue. The *ejusdem generis* principle directs that "if the specific words in the list are of the same class, the general word following them is construed as also being limited to that class" (J F Burrows and R I Carter, *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 233).

17. Nothing suggests that s CB 13(1)(b)(iv) should not be read in line with the *ejusdem generis* principle[1]. Applying this principle means that the wide words

[1] See *Skycity Auckland Ltd v The Gambling Commission* [2007] NZCA 407, [2008] 2 NZLR 182 on the requirements that must be satisfied for the principle to be applied.

("any other amenity, service or work …") in s CB 13(1)(b)(iv) should be read as limited to works within the same class as the specifically listed works.

18. However, there are different possible interpretations of what class the list of specific words form. "Channelling, contouring, drainage, earthworks, kerbing, levelling and roading" could be seen as all being works that are:
    - physical development work on the land; or
    - developmental work, as opposed to things that are purely division work.

19. The Commissioner considers the better view is that the class of specific works in s CB 13(1)(b)(iv) should be regarded as being developmental works, as opposed to purely divisional. The Commissioner does not consider that the class of works is limited to physical developmental works. In particular, the Commissioner notes that s CB 13 refers to work on **or relating to** the land. This suggests that developmental work other than physical developmental work **on** the land was intended to be included in the significant expenditure determination. Similarly, the fact that s CB 13 refers to any other "service" (and to a lesser extent "amenity") in addition to any other "work" on or relating to the land suggests that non-physical developmental work should be included.

20. Accordingly, applying the *ejusdem generis* principle would mean that the wider "or any other amenity, service or work …" words would encompass other physical developmental work not already listed (such as paving, retaining, sewage piping, power cabling, demolition and site clearing) and other developmental work that is not physical work on the land (such as preparation of a zoning application, the drawing of engineering plans and specifications, and the provision of estimates). The application of the *ejusdem generis* principle would exclude from consideration any work that was purely division work on or relating to the land (such as surveying that is related to the division of the land, as opposed to surveying related to development of the land, and the preparation and deposit of subdivision, unit title or flats plans).

21. The Commissioner notes that in the two relevant cases on what is now s CB 13, *Aubrey v CIR* (1984) 6 NZTC 61,765 (HC) and *Mee v CIR* (1988) 10 NZTC 5,073 (HC), survey costs were taken into account. However, the taxpayer in *Aubrey* had accepted that these costs were to be included. In *Mee*, the taxpayer submitted that the survey costs should not be taken into account, based on observations of Ongley J in *Wellington v CIR* (1981) 5 NZTC 61,101 (HC) (a case concerning what is now s CB 12). In that case, Ongley J had expressed the view that "development or division work" in what is now s CB 13 encompassed only things that were developmental in nature. In *Mee*, Hardie Boys J, while noting the decision in *Aubrey*, indicated that he tended to share Ongley J's view. Hardie Boys J did not need to decide whether survey fees should be included in the context of the *Mee* case, as the outcome would not have differed. For the reasons discussed above, the Commissioner considers that expenditure for work that is purely division work should not be taken into account.

22. It is noted that "development" in the context of s CB 13 means development in the sense of the preparation of the land for an intended use. It does not include the construction or erection of buildings (*Dobson v CIR* (1987) 9 NZTC 6,025 (HC)).

Qualification to IG0010 "Work of a minor nature"

23. IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5, at 9–10, states that development work entails some form of physical work being undertaken in relation to the land. The Commissioner no longer considers that statement to be correct. *Smith v CIR* (No 2) (1989) 11 NZTC 6,018 (CA) makes it clear that development work does not have to be physical work. As McMullin J stated at [6,024–6,025]:

> What then is meant by the words "development or division into lots". There is a degree of overlapping in that phrase. Some development work may not be division work and vice versa, but generally speaking the two will go hand in hand. "Division" is not defined in the *Land and Income Tax Act* or the *Local Government Act 1974* which deals with the subdivision of land. "Development" is also not defined. This rather suggests that the framers of the tax legislation intended that the phrase "development or division" is not to be narrowly construed when considered in relation to an undertaking or scheme. By declining to define "development or division work" sec 88AA(d) leaves the exact nature of the work wide open. **Development work frequently involves physical work on the land itself but need not necessarily do so.** In their concession that the letting of the sewage contract in October 1971 was capable of construction as a development work, counsel for the appellant rightly recognised that a contractual step which anticipates physical work but itself falls short of it may be development work. In my view development work on a subdivision of land may cover a range of activities including, in appropriate cases, the preparation of a zoning application without which the subdivision and resulting sales at a profit could never be achieved, the drawing of engineering plans and specifications for roads, the provision of estimates, the preparation

> of subdivisional plans, the letting of the necessary contracts and the resulting physical work involving the construction of roads, rights of way and culverts.
>
> [Emphasis added]

24. Similarly, Bisson J stated at [6,026]:

> If he [counsel for the taxpayer] accepts as a matter of law that legal work can be division work in a scheme involving division into lots, there can be no justification as a matter of law and logic for not accepting legal work as development work in a scheme involving development. This would also be the case if the scheme involved both development and division into lots of the land in question.

25. On the basis of this Court of Appeal authority, the Commissioner considers that IG0010 incorrectly suggests that only physical work can be "development" work. IG0010 no longer represents the Commissioner's view in this regard.

Is work found in both major and non-major projects included?

26. It has been suggested that only categories of work that are found in major projects but not also in minor projects are relevant for s CB 13 purposes. This view is based on the fact that the focus of s CB 13 is major projects, and the list of specific works in the section is intended to distinguish s CB 13 from s CB 12. It has been suggested that to include categories of work that are also found in minor projects would undermine this distinction.

27. The Commissioner does not agree that only categories of work found in major projects, not those found in both major and minor projects, are included in the significant expenditure determination. The categories of work specified in s CB 13 are not things that are exclusive to major projects. Earthworks, drainage, contouring, channelling, levelling, etc may be undertaken in both minor and major projects. What is telling, in terms of whether s CB 13 applies, is whether the expenditure on all of the work included in the provision is significant. If the expenditure on such work is significant, that means the project is sufficiently major to attract the application of s CB 13.

Does the work have to be undertaken or provided in the context of an industrial, commercial or residential development?

28. For s CB 13 to apply, the amenity, service or work does not need to be undertaken in the context of a commercial, industrial or residential development. The amenity, service or work only needs to be of a type **customarily** undertaken or provided in major projects involving the development of land for commercial, industrial or residential purposes.

29. It has been suggested that to be relevant for s CB 13 purposes the level of expenditure on any of the specific works listed in s CB 13 must be such as one would customarily find in major projects involving development for industrial, commercial or residential purposes. Alternatively, it has been suggested that the expenditure on any of the specific works will only be included if the work undertaken is of a kind or scale that might occur in major projects involving development for industrial, commercial or residential purposes.

30. All of the specific works mentioned in s CB 13 **are** customarily undertaken or provided in major commercial, industrial or residential development projects. The expenditure on, or scale of, such work does not need to be what would customarily be found in such major projects. Rather, **all** of the expenditure on such works is relevant, together with any expenditure on work that falls within the "catch-all" wider words in the provision (which must be work customarily undertaken in major projects involving development for commercial, industrial or residential purposes, as the specifically listed items are). It is necessary to ascertain whether the **totality** of this expenditure is significant. The Commissioner's view is that the expenditure on work in any particular category does not need to be significant, or at a level one might customarily find in major commercial, industrial or residential developments, to be included in the significant expenditure evaluation.

Does a person's time, effort and use of their own machinery need to be taken into account?

31. In both *Aubrey* and *Mee*, the court considered that the taxpayers' time (and the taxpayer's family's time in *Aubrey*) was relevant in assessing whether the expenditure was significant. In both cases, the use of the taxpayer's own machinery was also considered to be relevant. In *Aubrey*, Tompkins J noted that the expenditure of time and the use of machinery could not be quantified in monetary terms, but were nonetheless relevant. In *Mee*, Hardie Boys J made a monetary allowance (which equated to $306) for the taxpayer's time and the use of his machinery.

32. The Commissioner does not consider that a taxpayer's (or other person's) time, effort or use of their machinery or other equipment is a relevant consideration for s CB 13 purposes. If it were intended that non-monetary expenditure be taken into account, the provision could simply have stipulated that it applied where the development or division involved major or significant work on the specified activities (or

any other work, etc). The fact that s CB 13 requires that "the development or division **work involves significant expenditure**" (emphasis added) suggests that "expenditure" was meant to mean something other than simply work or the use of energy or other resources. The Commissioner considers that "expenditure" in s CB 13 should be read in the sense it is generally used in taxing statutes—an outlay of a monetary sum. Whether the expenditure needs to be incurred at the time an amount is derived from any given disposition of land is discussed below.

33. Although the taxpayer's labour (or the unpaid labour of others) is not relevant for determining whether there was significant expenditure, any expenditure on labour, including payments to working owners/working partners etc for services performed, should be taken into account for s CB 13 purposes.

34. Although the use of a taxpayer's machinery is not relevant for determining whether there was significant expenditure, there may be some associated expenditure that is relevant, for example, the cost of fuel used in the machinery, as this is monetary expenditure. Similarly, expenditure on the purchase or hire of machinery or other equipment would be relevant. In the case of the purchase of machinery or equipment, it may be appropriate to apportion the expenditure to reflect the use related to the undertaking or scheme.

Is future expenditure not yet incurred on the undertaking or scheme taken into account?

35. Another issue sometimes raised is whether intended future expenditure on the undertaking or scheme should be taken into account, or just expenditure that has been incurred at the time an amount is derived from the disposition of the land in question.

36. Section CB 13 is concerned with the development or division work of the **undertaking or scheme**, not just that carried out in relation to a particular piece of land involved in the undertaking or scheme. Some of the development or division work may be yet to occur at the time an amount is derived from the disposition of a particular piece of land. The provision's focus being on the work of the undertaking or scheme may arguably suggest that intended future expenditure on development or division work that is part of the undertaking or scheme should be taken into account. However, the wording of s CB 13 does not make clear whether all of the expenditure related to the undertaking or scheme should be taken into account, even if it has not been incurred at the time an amount is derived from the disposal of some of the land.

37. Prior to the Income Tax Act being rewritten for improved clarity (which was done progressively from 1994), s CD 1(2)(g) of the Income Tax Act 1994 (as it then was) referred to development or division work (being work involving significant expenditure on the specified things) that "**has been** carried on or carried out". This earlier wording of the provision tends to indicate that what should be taken into account is only expenditure that had been incurred at the time an amount is derived from the disposal of the land in question.

38. Section YA 3 of the Income Tax Act 2004 and s ZA 3 of the Income Tax Act 2007 set out transitional provisions relating to the rewrite of the Act, and they stipulate that the rewritten provisions were intended to have the same effect as the corresponding provisions in the ITA 1994 and ITA 2004 respectively (unless the subject of an identified policy change, or subsequently amended).

39. What is now s CB 13 was not specified in Schedule 22A of the ITA 2004, and is not listed in Schedule 51 of the ITA 2007. Therefore, the provision was not the subject of any intended policy change as part of the rewrite, and it was intended to have the same effect as the corresponding provision in the ITA 1994. As is clear from the provision as it was in the ITA 1994, the development or division work had to **have been** carried on or carried out at the time an amount is derived from the sale or disposition in question.

40. The Commissioner therefore considers that intended future expenditure on the undertaking or scheme should not be taken into account; only expenditure that has been incurred at the time an amount is derived from the disposition of the land in question is relevant to whether that amount is income under s CB 13.

When will expenditure be "significant" for s CB 13 purposes?

41. The second of the two main issues arising is when expenditure will be regarded as "significant" for s CB 13 purposes. As noted above, the question is whether the totality of the relevant expenditure is significant, not the expenditure in any given category.

42. In *Aubrey*, Tompkins J noted that the circumstances of a particular case will determine whether expenditure is significant, and that it is a matter of fact and degree.

43. The taxpayer in *Aubrey* had some coastal farm land. There was a settlement of some 50–60 families who resided on part of the land in consideration for a small amount of rent. The taxpayer decided to subdivide off that part of the farm land. He prepared (and

the county council approved) a scheme plan for 105 residential sections on approximately 17 acres, together with roadways, access ways and an esplanade reserve. The work that was required to effect the subdivision included: the grassing of sand to prevent erosion, the installation of stormwater drainage, some roading, the boxing and concreting of manholes, and the electricity (which had been brought to the area prior to the subdivision) being extended.

44. The total cost of materials supplied and work done by contractors was $20,280 (in 1967 dollars). This included surveyor's costs, insurance and legal expenses. The taxpayer also undertook some work himself. The county engineer at the time described the county's conditions of approval as very low by the then current standards. The roads were not sealed, there was no kerbing, channelling, water or sewerage, and the depth of metal required on the roadway was minimal.

45. In finding that the expenditure in *Aubrey* was significant and that s CB 13 therefore applied, Tompkins J commented at [61,770]:

> In weighing up whether the work involved expenditure that was significant, I have had regard to the size of the resulting subdivision (105 sections), the nature and extent of the physical work carried out as described in the evidence, the value of the land that resulted from the expenditure ($168,000), and the circumstances and location of the subdivision and the standards considered appropriate. In doing so I have not found it helpful to use dictionary definitions to translate "significant expenditure" into other words. I prefer to consider those words in their plain and ordinary meaning.
>
> Having done so, I am satisfied that the expenditure was significant in the contexts to which I have referred. It resulted in the completion of a relatively large subdivision. That involved some considerable roading and the formation of rights of way. It also required the provision of stormwater drainage. Ignoring the expenditure of time and equipment by the objector, $20,280 is 12% of the resulting value of the land. It would be a considerably higher proportion of the pre subdivision value. In my opinion, viewed in relation to a seaside holiday subdivision requiring only modest subdivisional standards, an expenditure in 1967 of $20,280 or in 1983 of $109,620 (both increased by the value of the objector's work and machinery) can hardly be regarded as insignificant.

46. The fact that Tompkins J had regard to the context of the subdivision (in particular the modest standards imposed on it) has been criticised by some[2]. However, the Commissioner agrees with Tompkins J's point that expenditure at the level it was, in the context of a development project that did not have very high standards imposed on it, emphasises the significant nature of the expenditure. That is, the expenditure in absolute and relative terms was even more starkly significant when one considered that the development project did not have very high standards imposed on it. With lower than typical standards one would expect lower expenditure in absolute and relative terms than what was incurred by the taxpayer in *Aubrey*. The Commissioner agrees that the context can be informative as to how significant the expenditure is.

47. The present-day regulatory context, including the existence of the Resource Management Act 1991, may mean that, in absolute terms, the expenditure on an undertaking or scheme of development is higher (accounting for inflation) than it would have been historically. The existence of higher regulatory standards may also mean that expenditure relative to at least the pre-development value of the land may be less likely to be regarded as significant than such relativities might have suggested historically, when such standards were not imposed. However, the increased costs associated with the current regulatory environment would, generally speaking, be expected to be reflected in property values. As such, expenditure relative to post-development values may not be significantly altered by higher current day regulatory standards. It may be that the context in which some expenditure related to regulatory requirements arises is a relevant consideration for s CB 13 purposes. For example, if someone had to deal with a particularly litigious party in the Environment Court and the development costs were therefore more than would usually arise for a similar development project, that might be a relevant contextual consideration in assessing whether the overall expenditure was significant.

48. The other case that concerned whether expenditure was significant for s CB 13 purposes is *Mee*. The taxpayer in that case had been farming a property in Queenstown. A 2-hectare strip of the land was unsuitable for farming, so the taxpayer decided to subdivide it into 22 sections for sale. The road adjacent to the land was unsealed at the time, and there was no water or sewerage reticulation. The local authority consented to the subdivision subject to some conditions. The taxpayer had to enter into a contract to pay the council half of the estimated costs of additional roading being formed and the length of the road that fronted the subdivision being sealed.

[2] See, for example, John Prebble, *Taxation of Property Transactions* (Butterworths NZ Ltd, Wellington, 1986) at [§12.6].

Further, the taxpayer had to enter into a contract to pay $580 per section towards the cost of providing water and sewerage services to the sections (which the council would install in the future as necessary). The taxpayer also had to create access ways to some of the sections, provide storm water drainage and provide necessary easements.

49. Hardie Boys J accepted that the payment to the council for the future roading, water and sewerage should not be taken into account in this case. This was because that work, if and when ultimately done, would not be "carried on or carried out by or on behalf of the taxpayer on or in relation to the land".

50. It is noted that the payments to the council in *Mee* were to cover the cost of the work if and when the council deemed it necessary in the future. In a situation where a taxpayer paid a council or other authority for some services or work being provided, that expenditure would be relevant for s CB 13 purposes.

51. Other council contributions such as development contributions for additional community and network infrastructure would not be taken into account for the purposes of s CB 13. Such contributions typically go towards the cost of public infrastructure that is needed to meet the additional demands arising from the population growth in an area—for example transport, open space reserves, and community facilities. Similarly to the local authority fees in *Mee*, such contributions would not be for work to be done on behalf of the taxpayer.

52. In *Mee*, Hardie Boys J considered that, at most, the relevant costs were: the survey fees ($2,647), the valuation fees ($617), the cost of pipes and gravel for the formation of the access ways ($180), and an allowance for the use of the taxpayers' machinery and for the value of the time he spent on physical work on the land ($306)—a total of $3,750. [As discussed above, the Commissioner considers that division costs should not be taken into account, and neither should the taxpayer's labour or the use of their machinery. Hardie Boys J included the survey fees, but noted that he tended to think they should not be taken into account. However, he did not need to decide the matter in *Mee* as the outcome did not turn on this.]

53. Hardie Boys J found that the expenditure of $3,750 was not significant in terms of what is now s CB 13, noting that the statutory emphasis was on major projects. He considered the amount of expenditure in absolute terms, and also relative to the number of sections, and to the value of the land pre and post division. Hardie Boys J commented as follows at [5,077]:

> In *Aubrey*, Tompkins J considered that the decision as to whether the relevant expenditure was significant in terms of para (e) had to be based inter alia on its relativity to the nature of the subdivision and the value of the completed project. It must always be a matter of fact and degree in the individual case, but nonetheless it must be remembered that the statutory emphasis is on "major projects". I therefore doubt that expenditure of $3,750 (even in 1974 terms) could in any circumstances be regarded as significant. It plainly is not so when it is related to the other information that is available here. Divided amongst 22 sections, it amounts to $170 per section. The land as a block before subdivision was valued at $185,000 as at August 1973. The relevant expenditure was some 2% of that. By April 1977 14 sections had been sold, the average net proceeds being a little over $12,000. The expenditure per section was thus 1.4% of the average price. On any approach, the expenditure cannot in my opinion be regarded as significant.

54. The Commissioner considers that, on the basis of *Aubrey* and *Mee*, it is clear that whether expenditure is "significant" for s CB 13 purposes will be a matter of fact and degree in the circumstances of any given case.

55. In terms of how much expenditure will be regarded as "significant" for s CB 13 purposes, it must be borne in mind that the statutory emphasis is, as noted by Hardie Boys J in *Mee*, on major projects. The provision's focus on major projects colours the level of expenditure that will be regarded as "significant". That said, the Commissioner considers that the extent of the expenditure still needs to be considered. There is no "threshold question" of whether a project is "major"; the amount of the expenditure is what determines whether a project is sufficiently major to fall within s CB 13.

56. Section CB 12 also provides some indication as to what significant may mean in s CB 13. Undertakings or schemes that involve development or division work that is **not minor** will be caught by s CB 12 if commenced within 10 years of acquisition of the land in question. The different levels of work or expenditure required to fall within ss CB 12 and CB 13 further indicate that "significant" in s CB 13 was intended to be reasonably high, and what is **not significant** in terms of the provision is therefore reasonably high too.

57. Consideration of the amount of the expenditure relative to the pre and post development value of the land indicates how substantial the project is, and therefore whether the expenditure should be regarded as significant for s CB 13 purposes. It may well be that the amount of expenditure in absolute terms

is sufficiently high that it could only be regarded as significant, even though in relative terms it would not seem significant. Similarly, it may well be that the expenditure in relative terms appears significant, but when considered in absolute terms, and in the context of the project, it would not be regarded as significant.

58. It is impossible to draw definitive lines in terms of absolute amounts or relative percentages of expenditure to land value. Whether expenditure is significant for s CB 13 purposes will be a matter of fact and degree in the circumstances of any given case.

59. The nature and extent of the physical work carried out as part of the undertaking or scheme would indicate whether the project was a major one. However, s CB 13 is concerned with whether the **expenditure** is significant. The Commissioner considers that the nature and extent of the physical work is not instructive in that regard. That said, if the extent of the physical work carried on is suggestive of the project being a major one, typically that will go hand in hand with associated significant expenditure. However, this will not necessarily be the case—for example, where someone undertakes extensive physical development work on their land themselves without incurring a great deal of expenditure.

Examples

60. The following examples are included to assist in explaining the "significant expenditure" requirement of s CB 13. They do not consider any of the other requirements of s CB 13, including the requirement in s CB 13(1)(a) that the amount derived on the disposition is not income under any of ss CB 6 to CB 12 and CB 14. The examples also do not consider the potential application of any of the exclusions to s CB 13, or of any other potentially applicable provisions.

Example 1: Significant expenditure and progressive sales during a project

61. The G Family Trust owned some land near Hamilton, which had been farmed by the G family for three generations. None of the G family children wished to take over the farm, so the trust decided to subdivide the land into 18 equal-sized lifestyle blocks. Carrying out the scheme involved expenditure of approximately $200,000 on earthworks and metalling related to the creation of rights of way to the subdivided blocks. Approximately $100,000 was incurred on surveying and legal expenses related to the delineation of the boundaries of the new blocks. The land was valued at $1.4m prior to the subdivision, and the 18 lots sold for a total of $2.3m. The first three lots were sold (for a total of $350,000) early on in the course of the project, as they did not require the rights of way for access. At the time the sales of those lots settled, only $10,000 had been incurred on the earthworks. By the time the remaining lots were sold, all of the work had been completed.

62. The relevant expenditure for s CB 13 purposes totals $200,000—being the expenditure on the earthworks and metalling related to the creation of the rights of way. The expenditure on the survey and legal fees related to the delineation of the boundaries is not relevant expenditure for s CB 13 purposes, as it is not developmental work.

63. When the sales of the first three lots settled, $10,000 of relevant expenditure had been incurred on the undertaking or scheme. That amount of expenditure cannot be regarded as significant for s CB 13 purposes when considered relative to the value of the land, and the absolute amount of the relevant expenditure being only $10,000 is not sufficiently substantial to indicate that s CB 13 should apply to the sales of those lots irrespective of the relativities. The amounts derived on the sales of those three lots are therefore not income under s CB 13.

64. By the time the remaining 15 lots were sold, all of the $200,000 of relevant expenditure on the undertaking or scheme had been incurred. Prior to the commencement of the undertaking or scheme, the land was valued at $1.4m, and it sold for a total of $2.3m. The expenditure was therefore approximately 14.3% of the pre-development value of the land and approximately 8.7% of the post-development value of the land. The relevant expenditure as a percentage of the pre and post development value of the land is significant for s CB 13 purposes. Further, the absolute amount of the relevant expenditure of $200,000 is not sufficiently small to indicate that s CB 13 should not apply to the sales of the last 15 lots irrespective of the relativities. The amounts derived on the sales of those 15 lots are therefore income under s CB 13. The G Family Trust is able to claim a deduction under s DB 27 for the value of that portion of the land at the time the undertaking or scheme commenced.

Example 2: Significant expenditure and the context of the project

65. Yasmin and Alex owned a house on a 2000 m^2 semi-rural section. Yasmin and Alex decide to build a flat on the front part of the section before selling it. The property is on a hill, so the project included excavation, levelling, and construction of a retaining wall. In addition, water and sewage pipes to the new dwelling were laid, and a driveway paved. The development work, including relevant council consents, the drawing up of the plans for the preparation of the site, and all of the physical work, cost a total of approximately $60,000. The property was valued at $550,000 prior to the work, and sold for $1,000,000.

66. As noted, the total cost of the development work was $60,000. The cost of construction of the new dwelling is not relevant, as that work is not "development" work for the purposes of s CB 13, as it is not work in preparing the land for an intended use.

67. The relevant expenditure was therefore approximately 10.9% of the pre-development value of the land, and approximately 6% of the post-development value of the land. When considered relative to the pre-development value of the land, the expenditure appears to be significant. The absolute amount of the relevant expenditure being $60,000 is not by itself sufficiently small to indicate that s CB 13 should not apply to the sale of the land irrespective of the relativities. However, when the expenditure is considered in the context of it being for a relatively modest project on a single residential block, it is not regarded as significant for s CB 13 purposes. The amount derived on the sale of the property is therefore not income under s CB 13.

Example 3: Significant expenditure and absolute amounts

68. Kaching Ltd owns a piece of industrial-zoned land in Auckland. Kaching Ltd decides it is timely to develop and sell the land. Kaching Ltd decides to develop a shopping complex on the land, which, prior to the development, was valued at approximately $30m.

69. Kaching Ltd applied to have the land re-zoned for high-density commercial use, undertook master planning for the development, and commissioned a geotechnical report, an infrastructure report, an architectural plan and an archaeological assessment. Kaching Ltd engaged contractors to level the land, lay the water and sewerage pipes and install driveways, a carpark and associated kerbing. The shopping complex was then constructed, and Kaching Ltd is in negotiations with interested purchasers. Expenditure on the works, excluding the construction of the complex, totalled $1.25m.

70. All of the $1.25m expenditure is relevant for s CB 13 purposes, as it is all developmental in nature.

71. The expenditure was therefore approximately 4.2% of the pre-development value of the land. When considered relative to the pre-development value of the land, the expenditure does not appear overly significant. However, the absolute amount of the expenditure ($1.25m) is sufficiently substantial for the expenditure to be regarded as significant for s CB 13 purposes, despite the amount relative to the value of the land not seeming overly significant on its own. This conclusion is further bolstered when the expenditure is considered in the context of it being incurred as part of a major commercial development. The amount derived on the sale of the property will therefore be income under s CB 13. Kaching Ltd will be able to claim a deduction under s DB 27 for the value of the land at the time the undertaking or scheme commenced.

References

Related rulings/statements
IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5
Subject references
Income Tax, undertakings or schemes involving development of land or division of land into lots, significant expenditure, major projects involving development of land
Legislative references
Income Tax Act 2007 – ss CB 13, DB 27, ZA 3, and Schedule 51
Income Tax Act 2004 – s YA 3 and Schedule 22A
Income Tax Act 1994 – s CD 1(2)(g)
Case references
Aubrey v CIR (1984) 6 NZTC 61,765 (HC)
Dobson v CIR (1987) 9 NZTC 6,025 (HC)
Mee v CIR (1988) 10 NZTC 5,073 (HC)
Skycity Auckland Ltd v The Gambling Commission [2007] NZCA 407, [2008] 2 NZLR 182
Smith v CIR (No 2) (1989) 11 NZTC 6,018 (CA)
Wellington v CIR (1981) 5 NZTC 61,101 (HC)
Other references
J F Burrows and R I Carter, *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009)
John Prebble, *Taxation of Property Transactions* (Butterworths NZ Ltd, Wellington, 1986)

COMMISSIONER'S OPERATIONAL POSITION ON WHAT IS "SIGNIFICANT EXPENDITURE" FOR SECTION CB 13 PURPOSES

The purpose of this item is to inform taxpayers of the operational position being adopted by the Commissioner in relation to this matter.

The Commissioner of Inland Revenue has released QB 15/02: Income Tax – Major Development or Division – What is "significant expenditure" for section CB 13 purposes? QB 15/02 deals with what expenditure is taken into account for section CB 13 of the Income Tax Act 2007 purposes, and when such expenditure will be regarded as "significant".

QB 15/02 qualifies IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005) to the extent that it suggests that only physical work can be "development" work. QB 15/02 clarifies that non-physical work can be "development" work, and any expenditure on non-physical development work is to be taken into account for the purposes of section CB 13.

As the Commissioner's view has changed from the previous view expressed in IG0010, with regards to what is considered to be "development" work, and therefore what expenditure would need to be taken into account for section CB 13 purposes, the Commissioner will apply the following transitional operational position:

a) Where a taxpayer has incurred expenditure on non-physical development work before 1 April 2015 in reliance on IG0010, that taxpayer may rely on the Commissioner's previous position in IG0010, for that portion of the expenditure on the undertaking or scheme, provided the land is sold prior to 1 April 2017 (ie, expenditure for non-physical development work prior to 1 April 2015 will not be taken into account for the purposes of section CB 13).

b) The position described above in (a) does not apply to any expenditure on non-physical development work incurred on or after 1 April 2015 (ie, expenditure incurred on or after 1 April 2015 will be taken into account for the purposes of section CB 13 as set out in QB 15/02).

   For example, if expenditure for non-physical development work was incurred between June 2014 and June 2016, provided the land is sold before 1 April 2017, the expenditure on non-physical work incurred before 1 April 2015 will not be taken into account for the purposes of section CB 13. However, the expenditure on non-physical development work incurred from 1 April 2015 will be taken into account.

c) If the land is not sold within the two year transitional period (1 April 2015 to 31 March 2017) the Commissioner's view set out in QB 15/02 will apply, resulting in all expenditure on non-physical development work being taken into account for the purposes of section CB 13 regardless of whether or not the expenditure was incurred prior to 1 April 2015.

Where a taxpayer incurs expenditure on non-physical development work on or after 1 April 2015, the new position set out in QB 15/02 will apply—the expenditure will be taken into account for the purposes of section CB 13.

QB 15/03: INCOME TAX – CHANGING TO A DIFFERENT DEPRECIATION RATE FOR AN ITEM OF DEPRECIABLE PROPERTY

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

This Question We've Been Asked (QWBA) is about subpart EE (the depreciation rules).

Question

1. Can the depreciation rate that a taxpayer uses to depreciate an item of depreciable property change?

Answer

2. Yes; the annual depreciation rate that a taxpayer uses to depreciate an item of depreciable property can change in limited circumstances. This is when the depreciation rate used is not or is no longer the depreciation rate that **applies** to the taxpayer's particular item of depreciable property. This is the case in the following circumstances:
   - There is a change in legislation that means a different depreciation rate applies to the item.
   - The taxpayer changes from using a special rate to using the economic or provisional rate that applies to their item.
   - The Commissioner of Inland Revenue (Commissioner) sets a new depreciation rate that applies to the item of depreciable property.
   - The taxpayer has been using an incorrect depreciation rate.
   - The depreciation rate is no longer applicable due to a change in circumstances (for example, a change in the way the item is used by the taxpayer).

Glossary

3. The following terms are used in this QWBA:
   - "Asset class" is the description of a kind of item(s) of depreciable property set out in a depreciation determination for a specific industry or asset category in the Commissioner's Table of Depreciation Rates.
   - "Depreciation rate" is a rate set by the Commissioner for a certain kind of item(s) issued in a depreciation determination or a rate for depreciation purposes set in a legislative provision.
   - "Depreciation Determinations" are determinations issued by the Commissioner under ss 91AAF or 91AAG of the Tax Administration Act 1994 (TAA). They set out the description of the kind of item(s) in the item asset class the depreciation determination applies to, the estimated useful life of the item(s), and the depreciation rate(s) to be used.

Background

4. We have been asked if the depreciation rate a taxpayer is using for an item of depreciable property can change. This issue has been raised particularly because of the change to the depreciation rate for most buildings to 0% from the 2011/12 income year. This change has caused some taxpayers to review the asset classes and depreciation rates they are using for their items of depreciable property. In some cases this review has resulted in taxpayers finding another asset class and depreciation rate that better describes their item of depreciable property. Taxpayers have asked the Commissioner whether they can change to that other depreciation rate. This QWBA answers that question. Sometimes a change of rate situation arises as a consequence of an item of depreciable property being incorrectly identified, this QWBA does not address how items of depreciable property are identified. Guidance on this issue can be found in the items discussed below at [7].

5. Taxpayers have also asked about the role of s DB 65 in this context. Section DB 65 was inserted into the Income Tax Act 2007 because of the changes to the building depreciation rate. The section is a transitional rule that allows a deduction for commercial fit-out that has previously been depreciated as part of a building rather than as a separate item. Circumstances covered by s DB 65 are not dealt with in this item, as they are specifically dealt with in s DB 65 and not under the depreciation regime. The Commissioner has published guidance on how s DB 65 applies in Question We've Been Asked QB 13/01: Depreciation of commercial fit-out, *Tax Information Bulletin* Vol 25, No 5 (June 2013): 24.

Identifying the item of depreciable property

6. This QWBA focuses on the circumstances in which a taxpayer already using a depreciation rate for an item of depreciable property can change that depreciation rate. This means the taxpayer has already identified the item of depreciable property that is being depreciated.

7. Sometimes the issue of changing depreciation rates arises when a taxpayer has identified an item of depreciable property incorrectly, for example by identifying the item as a separate item of depreciable property when it is, in fact, part of another item. Identifying an item of depreciable property correctly is an important preliminary step to finding the

correct depreciation rate. The Commissioner has published some guidance on how to identify the relevant item of depreciable property in Interpretation Statement IS 10/01 "Residential Rental Properties – Depreciation of Items of Depreciable Property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16, and in Interpretation Statement IS 12/03 "Income Tax – Deductibility of Repairs and Maintenance Expenditure – General Principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68. This QWBA does not provide guidance on how to identify the item of depreciable property correctly.

8. Where a taxpayer has established that they have incorrectly identified their item of depreciable property, this will also often mean that the incorrect depreciation rate has been used. A taxpayer using an incorrect depreciation rate is one of the circumstances considered in this QWBA.

Explanation

One applicable rate

9. To depreciate an item of depreciable property, a taxpayer has to use a depreciation rate provided in the legislation or set by the Commissioner in a depreciation determination[1]. Some depreciation rates (for example for certain buildings, aircrafts or motor vehicles) are set out in the legislation (see ss EE 29, EE 31, EZ 13 and, EZ 14). However, most depreciation rates are set by the Commissioner by issuing a depreciation determination. There are three types of depreciation rates: economic rates, provisional rates and special rates. Economic rates are the most common depreciation rates and are often referred to as "general rates". Provisional rates are often issued prior to an economic rate being issued and may be issued generally or for a particular taxpayer. The mechanism by which the Commissioner sets depreciation rates is found in subpart EE of the Act and the TAA[2]. Economic rates and provisional rates are listed in the Commissioner's Table of Depreciation Rates. Special rates are specific to an item(s) of depreciable property and are issued to a particular taxpayer. Special rates are not listed in the Commissioner's Table of Depreciation Rates.

10. Given the wide range of items of depreciable property, it is not administratively possible to set a specific rate for every single item. The Act allows the Commissioner to set the same depreciation rate for similar or the same kind of items (see ss EE 27(4)(c), EE 28(3)(c) and EE 30(3)(c) and ss 91AAF and 91AAG of the TAA). The Commissioner does this by issuing a determination that sets a depreciation rate for the kind of item described in a particular asset class in either an industry or asset category. Given this, some kinds of items are described in a general way.

11. There are no legislative constraints on how the Commissioner describes the "kind of item" of an asset class in an industry or asset category to which the determination relates. However, depreciation rates are based on the estimated useful life (EUL) (see s EE 63) of the item or kinds of items (unless it is fixed life intangible property, when it is based on the property's legal life). An item's EUL is a key element in deciding whether kinds of items are similar or the same and should be grouped under one description of a kind of item(s) with the same depreciation rate.

12. The depreciation rules require a taxpayer to use the depreciation rate that **applies** to their item of depreciable property. The Act contemplates only **one** depreciation rate applies to the item of depreciable property. Section EE 16(3) suggests this with the words "the annual rate … that applies to the item". Similarly, ss EE 27, EE 28 and EE 30 all refer to "setting the economic depreciation rate that applies to a kind of item of depreciable property" (or "to items of a kind of depreciable property" in s EE 30).

13. A question arises as to how to work out what depreciation rate applies to an item of depreciable property. To find the depreciation rate, taxpayers must identify their item and then find the item description that **most accurately describes** the taxpayer's item of depreciable property. This is done by looking at the asset class descriptions in the industry and asset categories in the Commissioner's Table of Depreciation Rates. The depreciation rate for the identified kind of item is the rate that then **applies**. This is sometimes described as the "most applicable rate". Generally if there is an asset class description (other than a default asset class description) in the appropriate industry category that applies to the item of depreciable property, the depreciation rate for that asset class will be the applicable rate for the item of depreciable property and there is no need to look at the asset categories.

[1] The Act also allows most low value items to be depreciated as part of a pool using the pool method under ss EE 20 to EE 24. An item of depreciable property once it is added to a pool is then depreciated as part of the pool under the pool's depreciation rate.

[2] Economic rates are set under s 91AAF of the TAA. A provisional rate is a temporary depreciation rate set by the Commissioner where there is no existing economic rate that applies to an item of depreciable property (apart from a default rate). These rates are set under s 91AAG of the TAA. Special depreciation rates are applied for by specific taxpayers who are using an item of depreciable property in a "special" way, resulting in the Commissioner setting a special depreciation rate for that item. These rates are also set under s 91AAG of the TAA.

14. Often more than one asset class description may seem to fit an item of depreciable property—for example, the description in a default rate asset class[3] and the description in a more specific asset class may both describe the taxpayer's item or the description in an asset class listed in an industry category and the description in an asset class listed in an asset category may both describe the taxpayer's item. In this case the Commissioner's view is that the depreciation rate for the item in the more specific asset class is the applicable rate. This is because the asset class description must be the description that **most accurately describes** the taxpayer's item of depreciable property. The asset class description in a more specific asset class will generally be a more specific description and therefore more accurate than the default asset class description. Further, the asset class descriptions in the industry categories are generally more specific than the asset class descriptions in the asset categories. When determining the most accurate description for the item, the nature of the item and how the item is used by the taxpayer will be relevant considerations.
15. Depreciation is claimed on the basis of the "annual rate". "Annual rate" is defined in s EE 61 to mean "the annual depreciation rate **applying** to an item of depreciable property that a person owns". This means that determining the most applicable rate is an annual enquiry. In many cases this enquiry will be straightforward because the applicable rate for an item of depreciable property will not change from year to year. One way to assist with this annual enquiry would be to check new depreciation determinations issued by the Commissioner to see whether there are any new depreciation rates that apply to the taxpayer's items of depreciable property. Depreciation determinations can be found here: **http://www.ird.govt.nz/technical-tax/determinations/depreciation/**

Changing the depreciation rate

16. The Act does not provide any general mechanism for changing depreciation rates. The Act only provides a legislative mechanism to change the depreciation rate a taxpayer uses for an item of depreciable property in very specific circumstances (for example, s EE 36, which is discussed below).
17. However, the Commissioner considers changing the depreciation rate for an item of depreciable property is required outside these prescribed situations but only where the depreciation rate does not apply, or no longer applies, to the item. There are two broad categories of circumstances where the depreciation rate used for an item of depreciable property must change. The first category is where the rate change is provided for in the legislation. These circumstances are:
    - There is a change in legislation that means a different depreciation rate applies to the item.
    - The taxpayer changes from using a special rate to using the economic or provisional rate that applies to their item.
18. The second category is where the depreciation rate used is not, or is no longer, the one that applies to the item of depreciable property. This follows from the "one applicable rate" principle that there is one depreciation rate that applies to an item of depreciable property and that rate needs to be the rate with the asset class description that most accurately describes the item of depreciable property. The Commissioner considers that the depreciation rate needs to change in the following circumstances:
    - The Commissioner sets a new depreciation rate that applies to the item of depreciable property.
    - The taxpayer has been using an incorrect depreciation rate.
    - The depreciation rate set is no longer applicable due to a change in circumstances.
19. All of the above circumstances are discussed further below.

When does the new rate apply?

20. If it has been established that a taxpayer is required to change the depreciation rate they are using for an item of depreciable property, the question arises as to **when** the new rate will apply from. Depending on the circumstances that lead to the rate change, the change may be prospective or retrospective.
21. In most circumstances covered in this QWBA a change of asset class and depreciation rate will only be prospective, meaning that the taxpayer applies the new depreciation rate to the adjusted tax value of the item of depreciable property going forward. This is because the circumstances leading to the depreciation rate change are likely to occur prospectively or have prospective effect, such as the Commissioner issuing a new depreciation rate that applies to the item from a certain date.
22. Where a taxpayer has used an incorrect depreciation rate, if the requirements of s 113A (Correction of

[3] A "default rate" is a rate for kinds of items of a very general description. It is the rate a taxpayer reverts to when no more specific option is provided. A "default rate" often has the term "default class" in the description in the Commissioner's Table of Depreciation Rates.

minor errors in subsequent returns) of the TAA are met, the taxpayer is able to correct the error in their next income tax return. If the requirements of s 113A are not met, the taxpayer can make a voluntary disclosure or apply separately to the Commissioner under s 113 of the TAA to change the depreciation rate retrospectively. Section 113(1) of the TAA provides:

> **113 Commissioner may at any time amend assessments**
>
> (1) Subject to sections 89N and 113D, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.

23. Section 113(1) of the TAA provides the Commissioner with the discretion to amend assessments to ensure their correctness. Standard practice statement SPS 07/03 "Requests to amend assessments", *Tax Information Bulletin* Vol 19, No 5 (June 2007):8[4] sets out the current practice for the exercise of this discretion under s 113.

24. The following parts of this QWBA outline in more detail the different circumstances when a depreciation rate change for an item of depreciable property may arise.

There is a change in legislation that means a different depreciation rate applies to the item

25. Sometimes the depreciation rate for certain items of depreciable property is provided in the legislation rather than in a depreciation determination. Where legislative changes provide for such a statutory depreciation rate being introduced or altered, the taxpayer must change the depreciation rate they use if the new statutory depreciation rate applies to their item of depreciable property. In these circumstances, the change is clearly intended by Parliament and required by the legislation. Generally such legislative provisions will set out when the rate change applies from.

26. For example, ss EE 31, EZ 13 and EZ 14 have been amended to provide that buildings with an estimated useful life of 50 years or more will have a depreciation rate of 0%. Until the 2011/12 income year, taxpayers could depreciate their building at a rate set by the Commissioner in the relevant depreciation determination (generally 2% per annum). The new 0% rate is a statutory rate and, with effect from the 2011/12 income year, it overrides the rates for asset classes of these buildings previously set by determination issued by the Commissioner.

The taxpayer changes from using a special depreciation rate to using the economic or provisional depreciation rate

27. There are two situations when a taxpayer may change from using a special depreciation rate to using the economic or provisional rate that applies to their item.

28. The first situation is provided for in s EE 36. This section provides that a taxpayer may change from using a special rate that applies to their item of depreciable property to using the applicable economic or provisional rate. This is subject to s EE 36(2) which prevents a taxpayer from changing rates to defer deductions for an item's depreciation loss.

29. The second situation is when the circumstances that applied when a special rate was issued change materially or no longer exist, such as the item is no longer being used in a special way. A taxpayer may then be required to change from using the special rate to using the economic or provisional rate that applies to the item of depreciable property. Under s 91AAI of the TAA, the Commissioner may revoke a special rate determination where the circumstances that applied when the special rate was issued subsequently change. The Commissioner may issue a new determination at a different special rate or issue no new determination. Section 91AAI(3) states that the taxpayer has to use the economic rate or an applicable provisional rate if the Commissioner revokes the special rate determination without issuing a new special rate.

30. The Commissioner notes that there may also be situations where the opposite may occur. That is, a taxpayer already using the applicable economic or provisional rate for their item of depreciable property changes to using a newly issued special rate. However, generally a special rate will apply from when an item of depreciable property starts being depreciated.

The Commissioner sets a new depreciation rate that applies to the item of depreciable property

31. Sometimes the Commissioner sets a new depreciation rate for a kind of item(s) that more accurately describes the taxpayer's item of property. As a result, the new depreciation rate is the rate that applies to the item of depreciable property. This may happen, for example, when the Commissioner sets a new provisional or economic rate for a more specific kind of item(s). The Commissioner considers that the applicable depreciation rate for the particular item changes under these circumstances.

[4] This SPS is currently under review by the Commissioner.

32. There are different reasons why the Commissioner may set a new depreciation rate. A taxpayer can apply for a special or provisional rate under s 91AAG of the TAA if certain requirements are met[5]. A taxpayer who applies for and is granted a special or provisional depreciation determination for their specific item of depreciable property is able to use the special or provisional rate set in this determination to depreciate their item from the time the determination is stated to apply. As mentioned above, generally a taxpayer will apply for a special or provisional rate before they start depreciating their item. This means that they will use the special or provisional rate the Commissioner has issued from when they start depreciating their item.

33. The Commissioner also has an on-going power to issue depreciation determinations setting new depreciation rates (see ss EE 27, EE 28, EE 30 and EZ 23, and s 91AAF of the TAA). Sometimes depreciation determinations state that they apply only to items acquired on or from a certain date. However, the Commissioner may issue an economic or provisional rate that applies to an item of depreciable property that the taxpayer may already have been depreciating using an existing depreciation rate. This situation may often arise where the taxpayer is using an existing default rate and the Commissioner subsequently issues a determination with a more specific asset class description and depreciation rate that applies to the taxpayer's item of depreciable property.

34. As stated earlier, the applicable depreciation rate is the rate for the kind of item (ie, asset class) that most accurately describes the taxpayer's item of depreciable property. When the Commissioner sets an asset class and depreciation rate that more accurately describes a taxpayer's item of depreciable property, it is consistent with the purpose of the depreciation regime that the taxpayer should use this more accurate asset class and depreciation rate. This is because the new asset class and associated depreciation rate is more likely to be based on a more accurate EUL for the taxpayer's specific item of depreciable property. However, s 91AAF(3) of the TAA ensures that where the Commissioner sets a lower economic rate it cannot apply to an item that is already being depreciated using a higher applicable economic rate. This provision provides taxpayers protection from being required to change to the less favourable applicable depreciation rate.

Example 1

35. Johan owns a printing machine that uses integrated technology and consists of a screen printing base and a multiple-head inkjet print head he uses in his printing business. He uses the diminishing value rate of 16% for "Printing machines (screen)" in the industry category "Printing and photographic" to depreciate his printing machine. In May 2013, the Commissioner issues a general depreciation rate for "Printing machines (automated inkjet flatbed)" with an EUL of 10 years and a diminishing value rate of 20% applying from the 2013/2014 income year. This new asset class applies to Johan's type of printer.

36. Both asset class descriptions: "Printing machines (screen)" and "Printing machines (automated inkjet flatbed)", describe Johan's printing machine. However, the description "Printing machines (automated inkjet flatbed)" more accurately describes Johan's printing machine. From the 2013/2014 income year the new depreciation rate for "Printing machines (automated inkjet flatbed)" is the applicable depreciation rate for Johan's printing machine. Johan needs to use this depreciation rate to depreciate his printer from the 2014 income year.

Example 2

37. In the 2011 income year, Glamping Ltd, a tour operator, buys a yurt as a portable shelter for their glamping tours. The yurt is a circular tent with a waterproof poly-cotton canvas for the cover and a frame of cedar wood. The company depreciates the yurt using the straight-line rate of 30% for "Tents" in the industry category "Leisure". In 2013, the Commissioner sets a general depreciation rate for "Yurts", added to the "Leisure" industry category, with a straight-line rate of 17.5%. Glamping Ltd would like to know if the depreciation rate changes for their yurt.

38. Section 91AAF(3) of the TAA ensures that where the Commissioner sets a lower economic rate it cannot apply to an item that is already depreciated using a higher applicable economic rate. The Commissioner issued the determination setting the general economic rate to apply to "Yurts" which will apply for the 2013/14 and later income years. The depreciation rate does not change for Glamping Ltd's yurt. If Glamping Ltd acquired any further yurts during or after the 2013/14 year, Glamping Ltd should use the new depreciation rate of 17.5% for those new yurts.

[5] A special rate cannot be set for a building, an item of excluded depreciable property, or an item of special excluded depreciable property (see s EE 35(2)).

The taxpayer has been using an incorrect depreciation rate

39. Sometimes a taxpayer has chosen an incorrect depreciation rate to depreciate their item. This could occur because the wrong rate has been selected in error or the item has been incorrectly identified. As set out above, in the Commissioner's view the depreciation rate for the asset class description that most accurately describes the taxpayer's item is the depreciation rate that applies to that item. If a taxpayer does not use the depreciation rate for the asset class that most accurately describes the taxpayer's item of depreciable property, they are using an incorrect depreciation rate.
40. A taxpayer who has used an incorrect depreciation rate for their item of depreciable property needs to change to the correct applicable depreciation rate.

Example 3

41. Rose purchases a croissant machine for her French bakery. Like some of her other machines she depreciates the new croissant machine using a straight line rate of 8.5% for "Bakery machinery and equipment (default class)" in the "Bakeries" industry category. Rose has been depreciating the machine for three years when she discovers that there is an asset description "Croissant machines" with a straight-line rate of 10.5% in the "Bakeries" industry category in the Commissioner's Table of Depreciation Rates. Rose would like to know if she can change to depreciate her croissant machine at 10.5% for "Croissant machines".
42. Rose has used an incorrect depreciation rate, because she has not used the depreciation rate for the asset class description that most accurately describes her croissant machine. Rose needs to change to the correct depreciation rate and depreciate her croissant machine under "Croissant machines" with a straight-line rate of 10.5%. Rose has calculated that the net tax effect of using the wrong depreciation rate for her croissant machine amounts to less than $500 each year for the three income years she has been claiming depreciation for the machine. Applying s 113A of the TAA, Rose corrects this minor error in her current return and adjusts the depreciation rate and her fixed asset schedule accordingly.
43. If the annual net tax effect of using the wrong depreciation rate had been over $500, then Rose could have made a s 113 request to the Commissioner to have her previous year's assessments corrected for the under-claimed depreciation amounts. In this situation, the Commissioner would exercise her s 113 discretion to correct the relevant assessments. Alternatively Rose could include this adjustment in any wider voluntary disclosure that she has made.

Example 4

44. Carl buys a motor vehicle that is used to transport goods for his business. He depreciates his vehicle using a straight-line rate of 13.5% for "Motor vehicles—class NA (for transporting light goods, gross vehicle mass up to 3.5 tonnes)". In a later income year, he discovers that his vehicle in fact has a gross vehicle mass of more than 3.5 tonnes. There is the description for "Motor vehicles—class NB (for transporting medium goods, gross vehicle mass over 3.5 tonnes but not over 12 tonnes)" with a straight-line rate of 10.5% in the Commissioner's Table of Depreciation Rates. Carl now wants to know what he should do.
45. Carl has chosen a depreciation rate for his motor vehicle that does not apply and is incorrect. This is because the description "Motor vehicles—class NA (for transporting light goods, gross vehicle mass up to 3.5 tonnes)" does not accurately describe his motor vehicle with a gross vehicle mass of more than 3.5 tonnes. Carl needs to change to the correct applicable depreciation rate for "Motor vehicles—class NB (for transporting medium goods, gross vehicle mass over 3.5 tonnes but not over 12 tonnes)" with a straight line depreciation rate of 10.5%. Carl has calculated that the net tax effect of using the wrong depreciation rate for his motor vehicle amounts to more than $500 for each income year that he has been claiming depreciation for the motor vehicle. Therefore Carl is unable to apply s 113A of the TAA.
46. Carl makes a request to the Commissioner to exercise her discretion under s 113 of the TAA to amend previous assessments. This request by Carl is made in writing. Carl could also have made a voluntary disclosure. The request seeks to correct on an annual basis the net over-claimed depreciation amount resulting from Carl using the incorrect depreciation rate. The net over-claimed depreciation amount is the difference between the depreciation Carl has claimed using the wrong depreciation rate and the depreciation Carl should have claimed using the correct depreciation rate.

The Commissioner considers this request applying her current practice set out in SPS 07/03 "Requests to amend assessments", *Tax Information Bulletin* Vol 19, No 5 (June 2007):8. In this situation the Commissioner has agreed to the retrospective change in rates and the assessments have been amended accordingly. Carl adjusts his depreciation schedule to take account of the effect of this change in rates.

The depreciation rate is no longer the applicable rate due to a change in circumstances

47. A taxpayer may change the way they use an item of depreciable property or circumstances may change while an item is being depreciated. As previously outlined, depreciation is claimed on the basis of the annual rate, so that determining the applicable rate for an item of depreciable property is an annual enquiry. If circumstances do change, then the most applicable depreciation rate for the item may also change.

Example 5

48. ABC Constructions Ltd has equipment for its own use within the company, but it also has other equipment that is available for hire. It depreciates a forklift that is hired out short term using the rate for "Forklift trucks (8 tonnes and over used for short-term hire of 1 month or less only)" with a straight-line rate of 17.5%. The forklift will not be available to be hired in future income years, as it is going to be used for the business on a construction project from the 2013/2014 income year onwards.

49. ABC Constructions Ltd must use the applicable depreciation rate for their forklift for each income year. From the 2013/2014 income year the forklift is not used for hire anymore and the depreciation rate that applies is therefore the rate for "Forklift trucks (8 tonnes and over)" with a straight-line rate of 10.5%. ABC Constructions Ltd needs to use this depreciation rate to depreciate the forklift from the 2013/2014 income year.

References

Related rulings/statements
IS 10/01: Residential Rental Properties – Depreciation of Items of Depreciable Property
IS 12/03: Income Tax – Deductibility of Repairs and Maintenance Expenditure – General Principles
QB 13/01: Depreciation of Commercial Fit-out
SPS 07/03: Requests to amend assessments
Subject references
Depreciation, annual rate
Legislative references
Income Tax Act 2007 – ss EE 16, EE 27, EE 28, EE 30, EE 31, EE 35, EE 36, EE 61, EE 63
Tax Administration Act 1994 – ss 91AAF, 91AAG, 91AAI, 113, 113A

QB 15/04: INCOME TAX – WHETHER IT IS POSSIBLE THAT THE DISPOSAL OF LAND THAT IS PART OF AN UNDERTAKING OR SCHEME INVOLVING DEVELOPMENT OR DIVISION WILL NOT GIVE RISE TO INCOME, EVEN IF NO EXCLUSION APPLIES

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

This Question We've Been Asked is about ss CB 12 and CB 13.

Question

1. If an undertaking or scheme involving development or division of land is carried on by or for a person and the undertaking or scheme:
   - was begun within 10 years of the person acquiring the land, and involves more than minor work (s CB 12); or
   - involves significant expenditure on the types of work specified in s CB 13;

   is it possible that the amount derived on the disposal of some of the land is not income, even if none of the statutory exclusions from s CB 12 or s CB 13 apply?

Answer

2. Yes, it is possible that the disposal of land that is part of an undertaking or scheme involving development or division of land will not give rise to income under s CB 12 or s CB 13, even if none of the exclusions apply.
3. In many circumstances that are outside of the intended scope of ss CB 12 and CB 13 there will be an applicable exclusion. Therefore, in practice the need to satisfy the Commissioner that the provision should not apply, for the reasons discussed in this QWBA, may not arise. However it has been an area of uncertainty on which guidance has been sought, and arises from time to time.
4. If land is involved in an undertaking or scheme of development of land or division of land into lots, the amount derived on the disposal of the land might be income under s CB 12 or s CB 13 (the criteria of those provisions are set out below). There are exclusions[1] to those provisions that could be applicable.
5. But even if none of those exclusions apply (the situation we have been asked about), it is still possible that the disposal of some of the land will not give rise to income under s CB 12 or s CB 13. The Commissioner will accept that s CB 12 or s CB 13 does not apply to the disposal of any given part of the land if the taxpayer can provide satisfactory evidence that the undertaking or scheme was not carried on with a view to the disposal of that land. The Commissioner would expect to see evidence that there had been some other demonstrable plan in relation to the land in question.
6. The types of things that may be relevant in establishing that an undertaking or scheme was not carried on with a view to the disposal of the land in question include:
   - the details of the development or subdivision plans, resource consent applications etc;
   - any contracts or agreements entered into;
   - evidence as to the intended use of particular parts of the land;
   - whether the taxpayer apportioned costs relating to the development or division work between land they had a view to disposal of and land they are claiming they did not;
   - what ultimately happened in respect of the land in question; and
   - the reason(s) for the ultimate disposal of the land in question.
7. It should be emphasised that if an undertaking or scheme meeting the criteria in s CB 12 or s CB 13 is carried on, it does not matter **when** the disposal of land occurs. The mere passage of time will not, without other supporting evidence, necessarily be sufficient to show that the undertaking or scheme was not carried on with a view to the disposal of the land in question.
8. It should also be noted that it is only necessary that an undertaking or scheme meeting the relevant criteria has been carried on, it does not need to have been carried out (ie, brought to fruition). If an undertaking or scheme meeting the relevant criteria was carried on but was subsequently abandoned, the ultimate disposal of the land will still be caught by the relevant provision unless an exclusion applies or the taxpayer can establish that the undertaking or scheme was not carried on with a view to disposal of the land in question.

[1] These are: the residential exclusion (s CB 17), the business exclusion (s CB 20), the farm land exclusion (s CB 21) and the investment exclusion (s CB 23).

Division of land

9. In the case of an undertaking or scheme of division of land into lots, the undertaking or scheme necessarily involves the whole original block. If the undertaking or scheme was not carried on with a view to disposal of some of the land, the taxpayer would need to show that when the land in question is ultimately sold.

Development of land without division

10. If there has been development work but no division work, it does not matter if part of the block of land was not itself physically subject to the development work. It is not possible to contend that only the part of the block that was physically subject to the development work was involved in the undertaking or scheme of development. If an undertaking or scheme involving development work on a block was carried on, all of the land is involved in the undertaking or scheme.

Development and division of land

11. Similarly, where there has been an undertaking or scheme involving development work on some of a block of land, followed by the division off of part of the block, all of the original piece of land is regarded as involved in the undertaking or scheme. The undertaking or scheme may not have been carried on with a view to disposal of all of the land, but all of the land remains involved in the undertaking or scheme. In order to fall outside the relevant provision (presuming no exclusion applies) the taxpayer would need to show, at the time any particular part of the land is ultimately sold, that the undertaking or scheme was never carried on with a view to the disposal of that land.

A subsequent undertaking or scheme

12. Of course, if an undertaking or scheme involving development or division of land was **not** carried on with a view to the disposal of some of the land, the owner could still potentially derive income under s CB 12 or s CB 13 in relation to that land. It may be that there was a subsequent undertaking or scheme meeting the criteria in s CB 12 or CB 13. Where that is the case, the amount derived on disposal of that land would be income, subject to any exclusion applying or the taxpayer being able to satisfy the Commissioner that the subsequent undertaking or scheme was also not carried on with a view to disposal of the land in question.

13. On the other hand, it may be that land is involved in an undertaking or scheme meeting the criteria in s CB 12 or s CB 13 and then that land is subsequently involved in another undertaking or scheme involving development or division that is outside of the parameters of s CB 12 or s CB 13. This would not preclude the disposal of that land from giving rise to income. If land is involved in an undertaking or scheme of division that falls within either s CB 12 or s CB 13, it does not matter when the land is sold (as noted above) or if the land is subsequently developed or divided further.

Qualification to IG0010 "Work of a minor nature"

14. This item qualifies IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005) in one respect. IG0010 is regarded as incorrect in stating that when any of the lots resulting from a boundary adjustment are disposed of, any amount derived on the disposition will necessarily be income under s CB 12[2]. On this point, see further from [95].

Explanation

15. An amount is income of a person under s CB 12 if it is derived by them from disposing of land in circumstances where:
    - an undertaking or scheme (not necessarily in the nature of a business) is carried on by the person (or by someone for them),
    - the undertaking or scheme involves the development of the land or the division of the land into lots,
    - the development or division work is not minor, and
    - the undertaking or scheme was commenced within 10 years of the person acquiring the land.

16. An amount is income of a person under s CB 13[3] if it is derived by them from disposing of land in circumstances where:
    - an undertaking or scheme (not necessarily in the nature of a business) is carried on by the person (or by someone for them),
    - the undertaking or scheme involves the development of the land or the division of the land into lots, and
    - the development or division work involves significant expenditure on certain specified activities[4].

[2] Provided that the other requirements of s CB 12 are satisfied, and no exclusions are applicable.

[3] Provided the amount is not income under any of ss CB 6 to CB 12 or s CB 14.

[4] These are: channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.

17. In a situation where land has been divided, some of the land may be sold, while some is retained by the owner. The question we have been asked requires consideration of whether this retained land is effectively "tainted" by the division work, such that the amount derived on the eventual disposal of that land will be income if none of the exclusions apply.
18. In a situation where land has been developed but not divided, the issue is whether it is possible that the amount derived when the land is ultimately sold is not income, even if none of the exclusions apply.
19. This has been a somewhat contentious issue over the years. On one hand, some have taken the view that if the criteria set out in the bullet points at [15] or [16] above have been satisfied, the disposal of all of the land, whenever that occurs, will be income unless one of the exclusions listed in s CB 12(2) or s CB 13(2) applies. On the other hand, some have taken the view that ss CB 12 and CB 13 are limited to disposals of land that was part of an undertaking or scheme involving development or division carried on with a view to the disposal of the land in question.
20. From a practical point of view, in many situations the issue will simply not arise, because one of the exclusions will be applicable. The exclusions from ss CB 12 and CB 13 are: the residential exclusions (s CB 17), the business exclusion (s CB 20), the farm land exclusion (s CB 21) and the investment exclusion (s CB 23). Those provisions are set out in the appendix at the end of this item, but their application is not discussed in this item.
21. In situations where none of the exclusions can be relied on, the Commissioner accepts that there may be circumstances where the disposal of any given piece of land is nonetheless not taxable under s CB 12 or s CB 13.

Legislation

22. Sections CB 12 and CB 13 provide as follows:

CB 12 Disposal: schemes for development or division begun within 10 years

Income

(1) An amount that a person derives from disposing of land is income of the person if the amount is derived in the following circumstances:
- (a) an undertaking or scheme, which is not necessarily in the nature of a business, is carried on; and
- (b) the undertaking or scheme involves the development of the land or the division of the land into lots; and
- (c) the person, or another person for them, carries on development or division work on or relating to the land; and
- (d) the development or division work is not minor; and
- (e) the undertaking or scheme was begun within 10 years of the date on which the person acquired the land.

Exclusions

(2) Subsection (1) is overridden by the exclusions for residential land in section CB 17, for business premises in section CB 20, for farm land in section CB 21, and for investment land in section CB 23.

CB 13 Disposal: amount from major development or division and not already in income

Income

(1) An amount that a person derives from disposing of land is income of the person if—
- (a) the amount is not income under any of sections CB 6 to CB 12 and CB 14; and
- (b) the amount is derived in the following circumstances:
  - (i) an undertaking or scheme, which is not necessarily in the nature of a business, is carried on; and
  - (ii) the undertaking or scheme involves the development of the land or the division of the land into lots; and
  - (iii) the person, or another person for them, carries on development or division work on or relating to the land; and
  - (iv) the development or division work involves significant expenditure on channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.

Exclusions

(2) Subsection (1) is overridden by the exclusions for residential land in section CB 17, for business premises in section CB 20, for farm land in section CB 21, and for investment land in section CB 23.

Relationship with section DB 27

(3) Section DB 27 (Amount from major development or division and not already in income) deals with a deduction for the value of the land.

23. Section CB 23B provides as follows:

CB 23B Land partially sold or sold with other land

Sections CB 6 to CB 23 apply to an amount derived from the disposal of land if the land is—

(a) part of the land to which the relevant section applies:

(b) the whole of the land to which the relevant section applies:

(c) disposed of together with other land.

APPLICATION OF THE LEGISLATION

24. To determine whether the proceeds of disposal of any particular piece of land are taxable because of an undertaking or scheme of development or division, it is necessary to consider whether the disposal occurs in the circumstances detailed in s CB 12 or s CB 13. In relation to the question we have been asked, that requires considering whether the disposal relates to an undertaking or scheme involving the development of the land or the division of the land into lots having been carried on (s CB 12(1)(a) and (b) and s CB 13(1)(b)(i) and (ii)).

25. This is the crucial requirement in terms of the question asked. This QWBA does not consider the other requirements of ss CB 12 and CB 13—most notably whether development or division work is of a minor nature[5] (s CB 12(1)(d)) or involves significant expenditure on the activities specified in s CB 13(1)(b)(iv).

26. The following discussion considers what "land" is referred to in each part of the provisions, whether there has been an "undertaking or scheme" carried on, and what land is part of an undertaking or scheme involving development or division. The discussion then considers the circumstances in which it is considered that the disposal of land that was part of such an undertaking or scheme will not give rise to income under s CB 12 or s CB 13.

"The land"

27. As can be seen at [22], "land" is referred to in the opening words of s CB 12 and also in paras (b), (c) and (e) of subs (1). Similarly, "land" is referred to in the opening words of s CB 13 and also in the subparas (ii) and (iii) of para (b).

28. To determine whether the amount derived on the disposition of a particular piece of land falls within the relevant provision, it is necessary to identify the "land" referred to in each part of the provision.

29. The opening words of ss CB 12 and CB 13 refer to an amount that a person derives from disposing of land. Logically, the land referred to here must be the land disposed of—the land the disposal of which may or may not trigger a tax liability.

30. On the face of it, the subsequent references to "the land" in ss CB 12 and CB 13 would appear also to be the land disposed of (as the phrase used is "the land" which suggests "the land" previously referred to—ie, in the opening words of those provisions).

31. However, the Commissioner considers that those subsequent references to land should be read as referring to the land involved in the undertaking or scheme. This is supported by *Lowe v CIR* (1981) 5 NZTC 61,006 (CA), and is consistent with the existence of s CB 23B[6].

32. In applying s CB 12 or s CB 13, the land involved in an undertaking or scheme involving development or division must, therefore, be identified.

Undertaking or scheme

What is an undertaking or scheme?

33. In *Vuleta v CIR* [1962] NZLR 325 (SC), the Supreme Court considered the provision in the Land and Income Tax Act 1954 which included in assessable income (amongst other things) profits from the carrying on or carrying out of any "undertaking or scheme" entered into or devised for the purpose of making a profit[7]. Henry J accepted the *Shorter Oxford English Dictionary* meaning of the term "scheme", being (at 329):

> a plan, design or programme of action, hence a plan of action devised in order to attain some end; a project, an enterprise.

34. This broad definition has been approved in a number of land subdivision cases, including *Wellington v CIR* (1981) 5 NZTC 61,101 (HC) and *O'Toole v CIR* (1985) 7 NZTC 5,045 (HC).

35. In *Lowe v CIR* (1981) 5 NZTC 61,006 (CA), Richardson J noted that there is an element of vagueness and elasticity inherent in both the words "undertaking" and "scheme", and in the composite expression, but considered that "scheme" connotes a plan or purpose which is coherent and has some unity of conception, and similarly an undertaking is a project or enterprise organised and directed to an end result. See also *Smith v CIR* (No 2) (1989) 11 NZTC 6,018 (CA).

36. Although an undertaking or scheme is a project, plan, programme of action or enterprise directed to an end result, that does not mean that the end result cannot be to do different things with different parts of the

[5] On that, see IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005) at 5.

[6] Which recognises that the land disposed of in any given year may be only part of the land involved in the undertaking or scheme, to which the relevant section applies.

[7] That part of the provision is now s CB 3.

land. One can have devised an undertaking or scheme involving division of land in order to sell some of it and retain some of it for other purposes (*Wellington*).

37. Not a great deal is necessarily required for there to be an undertaking or scheme involving development or division, as noted by Richardson J in *Lowe*. And in *Smith v CIR* (1987) 9 NZTC 6,045 (HC) Williamson J held that there could be an undertaking or scheme despite the fact no physical work had taken place and no contractual commitment had been entered into within the ten-year period.

38. Further, the details do not have to have been settled for there to be an undertaking or scheme capable of being carried out. Also, some details may be later modified without that making the original scheme a new scheme altogether (*Cross v CIR* (1987) 9 NZTC 6,101 (CA)).

When does an undertaking or scheme commence?

39. The time at which an undertaking or scheme is commenced is relevant to both ss CB 12 and CB 13. Section CB 12 will only apply if the undertaking or scheme was begun within 10 years of the date on which the person acquired the land. And the commencement date of an undertaking or scheme is relevant in the context of s CB 13 because a deduction is allowed for the value of the land at that time (s DB 27).

40. The date of commencement is when the first step in carrying out the scheme takes place; when there is some act done that sets it in train (*Cross v CIR* (1985) 7 NZTC 5,054 (HC), *Cross* (CA), *Smith (No 2)* (CA)). It is a question of fact in any given case as to whether the undertaking or scheme has moved beyond conception to having been put into operation.

41. There could be a variety of things that indicate that an undertaking or scheme has been commenced, for example applying for local authority consent, assent or direction to proceed being given to persons engaged to carry the work out in whole or in part, some physical activity on the land, entering into a contract or arrangement by which the undertaking or scheme is put into operation (*Cross* (HC), *Cross* (CA)). In *Smith (No 2)* (CA), it was held that the hearing of an application for planning approval by way of specified departure, which preceded any contract-letting or other steps, marked the commencement of the undertaking or scheme. In that case, Cooke P noted that it was possible that the making or notifying of a planning application could itself potentially be enough.

42. It is clear from the case law that there must be some overt act done for the purpose of implementing the undertaking or scheme. Having completed preparation of an undertaking or scheme does not necessarily lead to its immediate commencement; the undertaking or scheme may be put on hold, or the preparatory work may result in a decision not to proceed with the undertaking or scheme. For an undertaking or scheme to have been commenced there must have been some act done for the purpose of carrying it out (*Cross* (HC), *Cross* (CA), *Smith (No 2)* (CA)).

43. The fact that an undertaking or scheme may need to be modified (for example as a result of local authority requirements) or may even have to be abandoned, does not mean that it was not commenced (*Cross* (HC)). Neither s CB 12 nor s CB 13 require that the undertaking or scheme is carried out (ie, completed), just that it is carried on. If an undertaking or scheme meeting the criteria in s CB 12 or s CB 13 was commenced, the fact that it may subsequently be modified, or abandoned altogether, will not mean that the ultimate disposal will not be taxable under the relevant provision.

What land is involved in an undertaking or scheme of development or division?

44. With an undertaking or scheme involving development, it may be that only part of a particular block of land is developed. However, the Commissioner considers that if there has been development work but no division work, it does not matter if part of the block of land was not itself physically subject to the development work. The Commissioner does not consider it correct to regard only the part of the block that was physically subject to the development work as being involved in the undertaking or scheme of development.

45. The Commissioner considers that "the land" referred to in paras (b), (c) and (e) of s CB 12(1)[8] is the physical land within the title (or titles) that are involved in the undertaking or scheme. If any of the land comprised in a particular title is developed, there has been development of "the land" involved in the undertaking or scheme. This accords with the fact that "land" is defined in s YA 1 (relevantly) as including any estate or interest in land. Estates and interests in land relate to physical land comprised in titles. There is nothing in the definition of "land" in s YA 1 that suggests "land" might mean something less than an estate or interest in a particular title, or, in the case of the provisions

[8] And similarly in subparas (ii) and (iii) of s CB 13(1)(b).

concerning physical work on land (such as ss CB 12 and CB 13), anything less than all of the physical land comprised in a particular title.

46. In the Commissioner's view, if an undertaking or scheme involving development work on a block was carried on, all of the land is involved in the undertaking or scheme. If s CB 12 or s CB 13 applies, the entire amount derived on the disposal of the block will be income.

47. Similarly, where there has been an undertaking or scheme involving development work on some of a block of land, followed by the division off of that part of the block, all of the original piece of land is regarded as involved in the undertaking or scheme. The undertaking or scheme may not have been carried on with a view to disposal of all of the land, but all of the land remains involved in the undertaking or scheme. In order to fall outside the relevant provision (presuming no exclusion applies) the taxpayer would need to show, at the time any particular part of the land is ultimately sold, that the undertaking or scheme was never carried on with a view to the disposal of that land (see further from [53]).

48. In the case of an undertaking or scheme of division of land into lots, the undertaking or scheme necessarily involves the whole original block. There is no question that there is a project or plan to divide the whole piece of land into lots.

49. An undertaking or scheme of development or division may involve land in more than one block (or certificate of title).

50. In terms of considering whether the development or division work is more than minor (s CB 12(1)(d)) or involves significant expenditure on the relevant activities (s CB 13(1)(b)(iv)), all of the development or division work that is part of the undertaking or scheme is considered.

When will an amount derived on the disposal of land involved in an undertaking or scheme of development or division *not* be income?

Does an exclusion apply?

51. As noted above, there are a number of exclusions from ss CB 12 and CB 13. These are: two residential exclusions (ss CB 17(1) and CB 17(2)), a business exclusion (s CB 20), a farm land exclusion (s CB 21), and an investment exclusion (s CB 23). If any of these exclusions apply, the amount derived on the disposal of the land in question will not be income under s CB 12 or s CB 13. This item does not consider the application of the exclusions. The situation we have been asked about is where none of the exclusions apply.

Can the taxpayer show that the undertaking or scheme was not carried on with a view to disposal of the land in question?

52. Even if none of the exclusions apply, the Commissioner accepts that there may be circumstances where the amount derived on the disposal of land involved in an undertaking or scheme of development or division within the parameters of s CB 12(a)–(e) or s CB 13 (b)(i)–(iv) does not give rise to income under s CB 12 or s CB 13.

53. For an amount derived from the disposal of land to be income under s CB 12 or s CB 13 the amount must be derived in the circumstances detailed in the relevant provision. That is, the land must be disposed of in the circumstances of an undertaking or scheme (meeting the relevant criteria) having been carried on. The Commissioner accepts that if a taxpayer can satisfactorily show that the undertaking or scheme was not carried on with a view to the disposal of some of the land, the amount derived on the ultimate disposal of that land is not derived in the circumstances of the undertaking or scheme having been carried on. In that situation there is no correlation between what the undertaking or scheme was about, so far as that land is concerned, and the disposal of that land.

54. This does not mean that any given disposal needs to in fact **occur** as part of the undertaking or scheme (though in many cases there will be no question that it has). As noted above, the undertaking or scheme meeting the relevant criteria only needs to have been carried on, it does not need to have been carried out (ie, brought to fruition). As noted by Hardie Boys J in *Cross* (HC), the fact that an undertaking or scheme may be abandoned does not mean that it was not commenced. Neither s CB 12 nor s CB 13 require that the undertaking or scheme is carried out (ie, completed). This was perhaps even clearer on the original wording of the predecessor provision to ss CB 12 and CB 13, which referred to undertakings or schemes that had been "carried on **or** carried out" (emphasis added). The removal of the words "or carried out" does not lead to a different conclusion—those words were not required, as any undertaking or scheme that was carried out would necessarily have also been carried on.

55. If an undertaking or scheme meeting the relevant criteria was carried on (whether or not it was carried through to completion), the disposal (whenever it occurs) of any part of the land will *prima facie* be

caught by the relevant provision. It is only where an exclusion applies or where the taxpayer can establish to the Commissioner's satisfaction that the undertaking or scheme was not carried on with a view to disposal of the part of the land in question that the amount derived will be income under the provision.

56. Of course, if an undertaking or scheme involving development or division of land was **not** carried on with a view to the disposal of some of the land, the owner could still potentially derive income under s CB 12 or s CB 13 in relation to that land. It may be that there was a subsequent undertaking or scheme meeting the criteria in s CB 12 or CB 13. Where that is the case, the amount derived on disposal of that land would be income (subject to any exclusion applying or the taxpayer being able to satisfy the Commissioner that the subsequent undertaking or scheme was also not carried on with a view to disposal of the land in question).

57. On the other hand, it may be that land is involved in an undertaking or scheme meeting the criteria in s CB 12 or s CB 13 and then subsequently involved in another undertaking or scheme involving development or division that is outside of the parameters of s CB 12 or s CB 13. This would not preclude the disposal of that land from giving rise to income. If land is involved in an undertaking or scheme of division that falls within either s CB 12 or s CB 13, it does not matter when the land is sold (as noted above) or if the land is subsequently developed or divided further.

58. The Commissioner considers that this approach is consistent with what can be ascertained about the purpose behind ss CB 12 and CB 13 (discussed from [60]). The Commissioner also considers that overall the case law supports this reading of the provisions—in particular *Church v CIR* (1992) 14 NZTC 9,196 (HC), *Cross* (HC) and *O'Toole*, and to a lesser extent *Paul Stephens Construction Limited v CIR* (1990) 12 NZTC 7,192 (HC). The relevant case law is discussed from [68].

59. The Commissioner does not consider this approach to be in conflict with s CB 23B. As noted above, s CB 23B provides that ss CB 6 to CB 23 will apply to an amount derived on the disposal of land if the land is all or part of the land to which the relevant section applies, or disposed of together with other land (see [23]). Section CB 23B ensures that the land that falls within the scope of the relevant taxing provision cannot escape taxation because it is divided and sold in parts, or sold together with other land. If a taxpayer can show that an undertaking or scheme within the parameters of s CB 12 or CB 13 was not carried on with a view to disposal of some of the land, the Commissioner accepts that s CB 12 or CB 13 **will not apply** to the disposal of that land. That is, that part of the land will not be within the scope of the relevant taxing provision. As such, when that particular land is sold, s CB 23B will not apply to bring the disposal to tax under the operative provision because the land cannot be regarded as "part of the land to which the relevant section applies". It was part of the land involved in the undertaking or scheme, but not part of the land to which the relevant section applies.

The purpose of the provisions

60. It is acknowledged that different conclusions may be drawn about the intended scope of ss CB 12 and CB 13. On balance, the Commissioner considers the better view is that the provisions were not intended to operate to the extent that an undertaking or scheme involving development or division was not carried on with a view to disposal. The following discussion briefly discusses what the history to the provisions, and the legislative context, suggests about their intended purpose, and why the Commissioner thinks the above is the better view.

61. The provisions were first introduced in 1973 as s 88AA(1)(d) and (e) of the Land and Income Tax Act 1954. There were originally two exclusions from these provisions—one is now the residential exclusion in s CB 17(2), and the other is now the farm land exclusion in s CB 21. Section 88AA(1)(d) and (e) were introduced to give effect to the October 1967 recommendation of the Taxation Review Committee (the Ross Committee) that the legislation ought to catch undertakings or schemes aimed at making a profit but entered into or devised *after* the purchase of the land[9]. There is no indication from the Parliamentary debates that it was intended that the new provision would go further than the Ross Committee recommendation and extend to all land that was involved in an undertaking or scheme involving development or division, whether or not the undertaking or scheme was essentially carried on with disposal in mind.

62. This apparent intention is supported by an Inland Revenue information release[10] published at the time the provisions were introduced. The information

[9] See: Hansard (14 September 1973) 386 NZPD 3653 and 3680–3681.

[10] "Taxation of profits or gains from sales of land – Section 9 of the Land and Income Tax Amendment Act 1973 – Section 88AA of Principal Act" (November 1973).

release indicates that it was not intended that the provision would catch land that had been the subject of development or division if the work was part of an undertaking or scheme that was carried on for the taxpayer's own use—such as for a home or investment (it is noted that there was no investment exclusion at the time).

63. After the decision of *Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522 (HC), additional exclusions from what is now s CB 12 were introduced. These were later extended to s CB 13. Though not contemporaneous with the introduction of what are now ss CB 12 and CB 13, Inland Revenue's commentary on the new exclusions at the time the legislation enacting them was introduced made it clear that Inland Revenue understood that the original intention was that what is now s CB 12 would only apply where land was developed or divided as part of an undertaking or scheme for the purpose of the subsequent disposal of the land[11].

64. It could be argued that the original exclusions from what are now ss CB 12 and CB 13 were intended to be exhaustive. However, the original exclusions (concerning the division of land that the person used themselves either as residential property or as farm land) appear to have simply been aimed at clarifying the situation in relation to scenarios raised during the Parliamentary debates on the Bill that introduced the provisions. Those exclusions were not in the Bill when it was originally introduced, but were added subsequently by way of a supplementary order paper.

65. The scenarios covered by the exclusions suggest that Parliament was not concerned with division of land owned and used by a taxpayer for farming or residential purposes, in order to maximise the amount derived on disposal (provided that in the case of farm land it would still be used for farming purposes). Nor does it appear from the scope of the original exclusions that Parliament was concerned with development or division for some reason other than disposal. The scope of the exclusions arguably indicates that the intention was to tax profits of people specifically attempting to make a profit out of the need for urban expansion, though not necessarily in the business of development or division. This is consistent with comments made in *Lowe* about the history of the provisions.

66. It has been suggested that the post-*Anzamco* legislative response shows that Inland Revenue conceded that the court applied what is now s CB 12 correctly. The Commissioner does not consider that this is the only inference that can be drawn from the post-*Anzamco* legislative response. Rather, it is considered that the addition of further exclusions was aimed at ensuring such a situation would not arise again.

67. While it is not entirely free from doubt, for the above reasons, the Commissioner considers that the apparent purpose behind ss CB 12 and CB 13 is consistent with an undertaking or scheme only giving rise to income under the provisions if it was carried on with a view to disposal of the land in question.

The case law

68. As noted above, the Commissioner also considers that overall the case law supports this construction of ss CB 12 and CB 13. There have been a number of cases that have considered ss CB 12 and CB 13, but they suggest different approaches to the issue at hand. Many of the cases discussed do not directly touch on the issue, however there may nonetheless be some inferences that can be drawn from the facts of those cases and from some of the comments made by the judges in those cases. On balance, the Commissioner considers that case law lends greater support to the view adopted. The following discussion summarises what the Commissioner considers can be taken from the relevant cases, including those which support interpreting ss CB 12 and CB 13 as applying more broadly.

Church

69. In *Church*, the High Court had to consider whether the amounts derived on the sales of two pieces of land were income under a predecessor to s CB 12. The taxpayer had purchased a block of land in August 1961. There were a number of subdivisions of the land over the years, some within the 10-year period after the taxpayer's acquisition of the land. The question for consideration was whether the taxpayer had formulated a scheme, before August 1971, that the disputed sales in 1983 and 1984 were part of.

70. Temm J considered that the sales in question were not part of a continuing scheme that commenced within the relevant 10-year period. The approach of the court in *Church* indicates that the fact that land was involved in an undertaking or scheme of development or division falling within s CB 12 (or s CB 13) does not necessarily mean that amounts derived on the sale of all of the land will be income. The amounts derived on the sales of land at issue in *Church* were not income because those pieces of land were not sold as part of

[11] See "Income Tax Amendment Act (No 3) 1983" (*Public Information Bulletin* No 126, May 1984).

any undertaking or scheme involving development or division commenced in the relevant timeframe (though there clearly were such undertakings or schemes).

71. If any more than minor subdivision of land within 10 years of acquisition had the effect of making the ultimate sales of all of the land taxable, regardless of whether the taxpayer had a view to the disposal of all of the land at the time the undertaking or scheme involving development or division was carried on, there would have been no question that the sales of the land in question in this case would have been taxed. The fact that the court held the sales not to be taxed under what is now s CB 12, but rather enquired as to whether the sales were part of a scheme formulated within the relevant 10-year period, indicates that the existence of a scheme of division meeting the criteria of the provision will not necessarily result in the ultimate sales of all of the land that was within the original block giving rise to income. The court's approach suggests that there needs to be some connection between the scheme and the sale of the land.

Cross

72. In *Cross* (HC), the taxpayers had subdivided half of a block of land over a number of years in accordance with five successive subdivisional plans. This involved significant expenditure on work of the type specified in what is now s CB 13. The taxpayers had argued in the High Court that there were three separate undertakings or schemes, and so therefore three separate commencement dates for valuation purposes[12]. The commencement date of an undertaking or scheme is relevant in the context of s CB 13 because a deduction is allowed for the value of the land at that time (s DB 27). However, Hardie Boys J of the High Court held that on the evidence there was one scheme which was planned and implemented progressively.

73. The implication that may be drawn from *Cross* (HC), and the possibility (implicitly accepted by the court) that there had been three separate schemes, is that it is necessary to identify which scheme the disposal of any particular piece of land relates to. This would have been relevant for valuation purposes in *Cross*, had there been held to be more than one scheme, but is consistent with the approach of the court in *Church* that the disposal must relate to an undertaking or scheme falling within the relevant provision.

74. Had there been held to be three schemes in this case, it appears the court would have accepted that the deduction for the value of the land allowed in relation to the second and third schemes would be the value of the land at the date of commencement of each of those schemes. If the existence of an earlier scheme involving the division of part of a block of land was considered sufficient to bring all of the land that was part of the original block within the scope of the provision, the deduction could only be for the value of the land as at the date the original scheme was commenced. The value of the land at the time a subsequent division scheme was commenced would be irrelevant, because it would be the earlier scheme that gave rise to the tax liability on the eventual disposal of all of the land. The fact that the court apparently accepted the possibility that there may have been multiple schemes (rather than one scheme implemented in stages), and the attendant proposition that this would mean different commencement dates for valuation purposes, suggests that the existence of a scheme meeting the criteria set out at [15] (s CB 12) and [16] (s CB 13) will not necessarily give rise to a tax liability for all of the land when it is eventually sold.

O'Toole

75. A few years after acquiring some farm land, the taxpayers in *O'Toole* had the land surveyed in order to establish its true boundaries, because they had struck some difficulties with the owner of neighbouring land. The surveyor they engaged advised them that he thought the Town and Country Planning Act was going to change, and as such he suggested that the taxpayers have the whole farm subdivided into blocks at that time. The taxpayers agreed with this suggestion, as they had decided to sell off some land in a few blocks to pay off their mortgage to the vendor, which was due in 1975.

76. In considering whether there was an undertaking or scheme for the purposes of what is now s CB 12, Davison CJ in the High Court commented that:

> The objectors entered into a project or enterprise directed towards the subdivision of their land into lots with the view to sale of those lots at a profit. **The scheme existed in the plan or purpose to sell off the lots not reserved by the objectors for their own use in order to realise the maximum available profit.**
>
> [Emphasis added]

77. Davison CJ had earlier cited the broad dictionary definition of "scheme" referred to by Henry J in *Vuleta* with apparent approval. The Commissioner therefore

[12] This argument was not pursued in the Court of Appeal.

QUESTIONS WE'VE BEEN ASKED

considers that Davison CJ was not suggesting that an undertaking or scheme can be confined to part of a block of land. Rather, the Commissioner considers it is implicit in the judgment that Davison CJ considered that though all of the land was involved in the scheme of division, the provision was not concerned with that part of the land that the taxpayers retained for their own purposes, but rather just with the land that the taxpayers had a view to disposing of.

Paul Stephens Construction

78. In *Paul Stephens Construction*, the taxpayer had two adjacent sections (lots 66 and 67), which were deemed to have been acquired at different times. The sections were subdivided within 10 years of the deemed acquisition of lot 67, but more than 10 years after the deemed acquisition of lot 66. One of the resulting lots (lot 2) comprised some land which had formerly been in lot 66 and some which had formerly been in lot 67.

79. It was held that the taxpayer's assessable income from the sale of lot 2 was limited to the profit relating to the part of that lot which had formerly been in lot 67.

80. *Paul Stephens Construction* is less relevant to the issue at hand, as there was no question about the undertaking or scheme of division in this case being carried on with a view to the disposal of all of the land. However it does provide some support for the view that the disposal must relate to the undertaking or scheme. *Paul Stephens Construction* indicates that the s CB 12 (or s CB 13) criteria must be considered in relation to each piece of land sold, as not all of the land will necessarily meet the criteria. The Commissioner considers that one of the criteria of ss CB 12 and CB 13 is that the amount must be *derived in the circumstances of an undertaking or scheme having been carried on*. As noted above, the Commissioner accepts that if a taxpayer can satisfactorily show that the undertaking or scheme was not carried on with a view to the disposal of some of the land, the amount derived on the ultimate disposal of that land is not derived in the circumstances of the undertaking or scheme having been carried on.

Anzamco

81. On the other hand, *Anzamco* supports the view that for the purposes of ss CB 12 and CB 13 the undertaking or scheme does not need to involve anything other than development or division (ie, it is irrelevant whether the undertaking or scheme was carried on with a view to the disposal of the land).

82. In *Anzamco*, the taxpayer company developed land over a number of years as a holiday resort or "ranch", for the use of its shareholders. The land was always intended to be kept by the shareholders and their descendants. However, after the death of one of the major shareholders, it transpired that none of his family, nor the families of the other major shareholders, were interested in taking over the ranch. In the end, the taxpayer decided to sell the land, some 13 years after its purchase.

83. Barker J held that what is now s CB 12 applied, and the proceeds of the sale were income. Barker J did not read the provision as requiring that the eventual sale of the land be related to the undertaking or scheme. The approach taken suggests that if ever an undertaking or scheme meeting the relevant criteria had been carried on in relation to land, the profits or gains on any subsequent sale would be assessable income, and what was in mind when the undertaking or scheme was carried on is irrelevant.

84. As discussed above, additional exclusions were introduced after *Anzamco* to directly reverse the effect of this decision.

Case J37

85. Similarly, *Case J37* (1987) 9 NZTC 1,219 supports the view that it is irrelevant whether the undertaking or scheme was carried on with a view to retaining rather than disposing of some of the land.

86. The finding in *Case J37* that what is now s CB 12 applied to the sale of one of the lots created by the subdivision (lot 5) is consistent with the view that disposal, or having a view to potential future disposal, does not need to be part of the undertaking or scheme. Although the other four lots created in the subdivision in this case were to be sold, that was not the position in relation to lot 5. Moore DJ did note that the situation in relation to lot 5 was "somewhat equivocal", as it was the "residual lot", but he nonetheless concluded that the proceeds derived on its sale fell within what is now s CB 12, even though unlike the other four lots it was not created with future disposal in mind.

Wellington

87. *Wellington* may likewise be read as supporting the view that it is irrelevant whether the undertaking or scheme was carried on with a view to retaining rather than disposing of some of the land.

88. Ongley J seemed to accept that the taxpayers had set aside the part of the land that became lots 6, 7 and 8 for their own residential purposes. Ongley J commented that the proceeds from the sales of lots 7 and 8 would fall within what is now s CB 12 unless

the residential exclusion applied—which he held was the case. This may be seem as indicating planning to retain rather than dispose of land does not preclude s CB 12 from applying; that the only way to escape taxation under the provision is by way of an exclusion. However, it is noted that there were various plans prepared before the subdivision in this case, and it is unclear why the taxpayers would have divided the land they resided on into three lots if they did not have a view to the sale of some or all of those lots. As it was, there was an exclusion available to the taxpayers, and in the circumstances of the case it is perhaps understandable that Ongley J considered the exclusion to be the only way in which the sales of the lots at issue would not be taxable.

Lowe

89. *Lowe* is sometimes referred to as suggesting that "residual" or "retained" land will be "tainted" by an undertaking or scheme of subdivision. The Commissioner does not consider that *Lowe* is relevant to the issue.

90. In *Lowe*, the entirety of the block in question was subdivided and sold. The taxpayer made a technical interpretive argument in relation to the wording of what is now s CB 12. The argument was that if a lot sold in any given year was not adjacent to another lot also sold that year, and no development work had been carried out on the lot sold, it could not be "that land" (as the reference in the provision then was). In other words, it was submitted that there could not be an undertaking or scheme of development or division involving the land sold if the particular lot had not been **itself** developed or divided into lots, or was not adjacent to another part of the original block that was also sold in the year (so they could be said to have been divided from each other). The court did not accept that argument.

91. There was no dispute on the facts in *Lowe* that all of the land was involved in and sold as part of the undertaking or scheme of division. In his judgment, McMullin J stated that "[i]t is sufficient for the purposes of the section if the developmental or surveying work was done on the total subdivisional area of which any lot or lots sold formed part". This statement has sometimes been taken as indicating that the sale of any land which was part of a lot that was divided will fall within s CB 12 (the criteria being met) unless an exclusion applies. That is, that the eventual sale of all of the land in the original block will be taxed, even if the sale of some of that land was not contemplated when the undertaking or scheme of division was carried on. The Commissioner does not consider that the above statement should be read as suggesting that all of the land is necessarily "tainted" by the undertaking or scheme, and the ultimate sales will therefore all be subject to tax. McMullin J's comment relates specifically to the technical "that land" argument that the taxpayer made. It should not be taken more broadly.

What approach do the cases suggest?

92. On one hand, *Church*, *Cross* (HC) and *O'Toole* may provide implicit support for the view that ss CB 12 and CB 13 should be read as not extending to amounts derived on the disposal of land if it can be shown that the undertaking or scheme was not carried on with a view to the disposal of the land in question. *Paul Stephens Construction* could also be regarded as providing some implicit support for this view. On the other hand, *Anzamco*, *Case J37* and *Wellington* support the view that if there has been an undertaking or scheme involving development or division, the disposal of all of the land will give rise to tax under s CB 12 or s CB 13[13] unless an exclusion applies (ie, it is irrelevant whether it can be shown that the taxpayer did not have the disposal of some of the land in mind when they were carrying on the undertaking or scheme).

93. All of the relevant cases are High Court or Taxation Review Authority, and the inferences that may be drawn from them are conflicting. However, it is noted that *Anzamco* was decided in 1983 and *Wellington* in 1981, both before *O'Toole* (1985), *Cross* (HC) (1985), *Paul Stephens Construction* (1990) and *Church* (1992), and *Case J37* was decided in 1987, before *Cross* (HC), *Paul Stephens Construction* and *Church*. It is also noted, as discussed above, that the result in *Anzamco* was regarded as being contrary to the original legislative intent, and so additional exclusions were introduced after that decision, to directly reverse its effect. In the circumstances, the Commissioner considers it appropriate to take direction from the legislative intent, and that it is preferable to follow the authorities which take an approach that is consistent with that—most of which were decided after *Anzamco* in any event.

94. In the Commissioner's view, the approach that the courts in the preferred authorities have taken, either expressly or implicitly, is that ss CB 12 and CB 13 will not apply to the disposal of any given piece of land if it can be established that an undertaking or scheme

[13] Presuming the other criteria are satisfied.

that the land was involved in was not carried on with a view to the disposal of that land. It is considered that the wording of the provisions can legitimately bear such a construction, and that it is consistent with the purpose of the legislation.

Boundary adjustments

95. IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005) at 5 states that a boundary adjustment will amount to a "division into lots" for the purposes of what is now s CB 12. IG0010 then states (at 10):

> ... It is therefore the Commissioner's view that, if a lot of land owned by a person is altered by transferring a part of the lot to, and including it in the title for other adjoining land owned by, another person there is a division into lots of the first-mentioned lot.
>
> ... if the boundaries between adjoining lots of land owned by the same person are altered, there is a division into lots of the land comprised of those adjoining lots; and **if any of the resulting lots is sold or otherwise disposed of any amount derived on the sale or other disposition will be gross income under section CD 1(2)(f) if the other requirements of section CD 1(2)(f) are satisfied**.
>
> [Emphasis added]

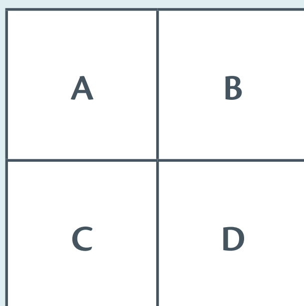
96. Although a boundary adjustment will amount to a division into lots, whether amounts derived on the disposal of any of the resulting lots will be income under s CB 12 depends on whether the undertaking or scheme involving the boundary adjustment[14] was carried on with a view to the disposal of the land in question. IG0010 no longer represents the Commissioner's position to the extent that it suggests otherwise.

Examples

97. The following examples are included to assist in explaining the application of the law set out above.

Example 1

Diagram 1



98. In 2002, Sam and Fiona bought a four acre block of land in Gisborne, where they planned to build their dream home and keep some chickens and perhaps a couple of cows. In 2003, part-way through the build, before they had moved in, they decided they did not wish to maintain such a large piece of land. Accordingly, between 2003 and 2004 they subdivided off and sold three one-acre sections (lots "B", "C" and "D" in Diagram 1). This subdivision involved work of more than a minor nature. In late 2004, Fiona's mother became terminally ill and Sam and Fiona and their 3 children moved to Wellington to care for her (Sam was able to get a contract there). Sam and Fiona envisaged that they would move back to Gisborne in a relatively short time. Fiona's mother passed away in 2006. By this stage, the family were well settled in Wellington, and enjoying life there, so they decided to stay. They sold the remaining one-acre section (lot "A") on which they had built the house.

99. The proceeds from the sale of lots "B", "C" and "D" would be income under s CB 12. There was an undertaking or scheme involving the division of the entire original block into lots, and there is no suggestion that Sam and Fiona did not carry on the undertaking or scheme with a view to the sale of lots "B", "C" and "D". The undertaking or scheme was begun within 10 years of acquisition of the land, and the division work was not minor. Neither of the residential exclusions apply. The exclusion in s CB 17(1) does not apply because the division was not for use in and for the purposes of Sam, Fiona or their family residing on the land. The exclusion in s CB 17(2) does not apply because the area of the original block of land exceeded 4,500 square metres, and in addition it was not occupied by Sam, Fiona or their family as residential land before it was divided.

100. The result would be the same irrespective of the number of lots divided off for sale (ie, even if the land to be sold was divided off in one lot, rather than three), provided that the other requirements of s CB 12 were met—including that the division work was more than minor.

101. The proceeds from the sale of the one-acre section with the house on it (lot "A") would not be income under s CB 12. Although there was an undertaking or scheme involving the division of the entire original block into lots, the undertaking or scheme was not carried on with a view to the sale of lot "A". Rather, lot "A" was subsequently sold for reasons unrelated to the undertaking or scheme of division.

[14] Or some other undertaking or scheme of development or division

Example 2

102. For the purposes of this example, it is presumed that there are no applicable exclusions. In particular, it is presumed that the farm land exclusion in s CB 21 would not apply because none of the land sold was capable of being worked as an economic unit as a farming or agricultural business.

Diagram 2

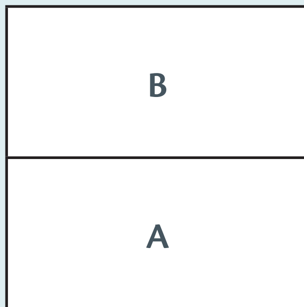
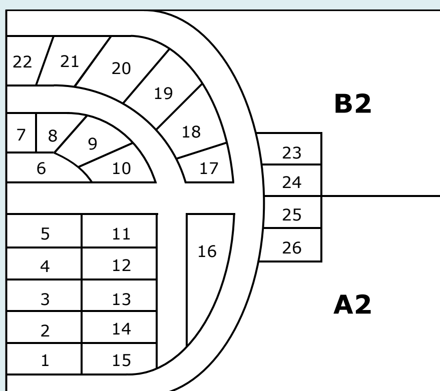


Diagram 3



103. Mr Webster had owned lot "A" in Diagram 2, situated on the outskirts of Dunedin, since 1972, and had farmed that land from the time he acquired it. In 1997, Mr Webster purchased an adjoining block (lot "B" in Diagram 2) when it became available, as he intended to extend his farming activities in partnership with his son upon his son's return from the UK in a few years. However, by 2001 Mr Webster's son had decided to remain in the UK, rather than return to New Zealand.

104. In light of sharply appreciating property values, and given that he was unable to farm all of the land on his own, Mr Webster decided to subdivide some of the land for residential sections (lots 1–26 in Diagram 3) and retain an area of what had been lot "A" (lot "A2" in Diagram 3) which he would continue farming, and an area of what had been lot "B" (lot "B2" in Diagram 3), which was never considered suitable for residential subdivision due to subsidence risks. Although not suitable for residential subdivision, lot "B2" would be able to be farmed, and Mr Webster intended to do so. The combined area of lots "A2" and "B2" was similar to that of original lot "A", which Mr Webster had been able to farm on his own.

105. From 2002 to 2005 the land to be subdivided (lots 1–26) was subdivided and most of it (lots 1–22) was sold as residential sections. However, over the course of the subdivision it became clear that, in addition to lot "B2", which had always been known to have substantial subsidence risks, four of the newly formed residential lots (lots 23 to 26) also had subsidence issues. Accordingly, lots 23 to 26 were not sold as residential sections, as originally planned.

106. In 2010, Mr Webster found a purchaser for lots 23 to 26 who wished to use the land for alpaca farming. However, the purchaser was only keen to buy lots 23 to 26 if he could also buy the adjoining lot "B2", and he made an attractive offer to do so. Given the appeal of the offer, and Mr Webster's declining health (and therefore inability to continue farming such a large area on his own for much longer), Mr Webster agreed to sell lot "B2" together with lots 23 to 26.

107. The land comprising the roads in the subdivision was transferred to the Council for nil consideration, as part of the consent process for the subdivision.

108. The proceeds from the sale of the residential sections situated on the land purchased in 1997 (lot "B" in Diagram 2) (lots 6–10 and 17–22) would be income under s CB 12. There was an undertaking or scheme involving the division of the entire original lots "A" and "B" into lots, and this division work was not minor. There is no suggestion that the undertaking or scheme was not carried on with a view to the sale of lots 6–10 and 17–22, and the undertaking or scheme was begun within 10 years of Mr Webster's acquisition of the land contained in those lots.

109. The proceeds from the sale of the residential sections situated on the land Mr Webster had owned since 1972 (lot "A" in Diagram 2) (lots 1–5 and 11–16) would not be income under s CB 12. Although the undertaking or scheme involved the division of the entire original lots "A" and "B" into lots, it was not begun within 10 years of Mr Webster's acquisition of the land in the original lot "A". The proceeds from the sale of those sections (lots 1–5

QUESTIONS WE'VE BEEN ASKED

and 11–16), however, may be income under s CB 13 if the work on, or relating to, all of the original lots "A" and "B" involved significant expenditure of the type referred to in s CB 13(1)(b)(iv).

110. The proceeds on the sale of lot "B2" would not be income under s CB 12. There was an undertaking or scheme involving the division of the entire original lots "A" and "B" into lots, and this division work was not minor. However, the undertaking or scheme was not carried on with a view to the sale of lot "B2". Lot "B2" was subsequently sold for reasons unrelated to the undertaking or scheme of division. It was known from the planning stages of the undertaking or scheme of division that lot "B2" was not suitable for residential subdivision, and Mr Webster had intended to keep and farm that section. He ended up selling it some five years after the sale of the residential sections, due to his declining health, and the fact that the purchaser interested in buying lots 23 to 26 was only interested if he could also buy lot "B2", and he made an attractive offer to do so.

111. The proceeds from the sale of lots 23 and 24 would be income under s CB 12. There was an undertaking or scheme involving the division of the entire original lots "A" and "B" into lots, and this division work was not minor. The undertaking or scheme was begun within 10 years of acquisition of the land contained in lots 23 and 24. There is no suggestion that the undertaking or scheme was not carried on with a view to the sale of lots 23 and 24. It is irrelevant that those lots could not ultimately be sold as residential sections as originally anticipated, and that it took some years for Mr Webster to find a purchaser for those sections.

112. The proceeds from the sale of lots 25 and 26 would not be income under s CB 12. Although the undertaking or scheme involved the division of the entire original lots "A" and "B" into lots, it was not begun within 10 years of Mr Webster's acquisition of the land in the original lot "A". However, the proceeds from the sale of those sections (lots 25 and 26) may be income under s CB 13 if the work on, or relating to, all of the original lots "A" and "B" involved significant expenditure of the type referred to in s CB 13(1)(b)(iv).

113. There was no amount derived on the disposition of the land comprising the roads and so there is no income to tax under either s CB 12 or s CB 13 for that land.

References

Related rulings/statements
IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005)
"Income Tax Amendment Act (No 3) 1983" *Public Information Bulletin* No 126 (May 1984)
Subject references
Income tax, undertakings or schemes involving development of land or division of land into lots
Legislative references
Income Tax Act 2007 – ss CB 12, CB 13, CB 17, CB 20, CB 21, CB 23, CB 23B and DB 27
Case references
Anzamco Ltd (in liq) v CIR (1983) 6 NZTC 61,522 (HC)
Case E90 (1982) 5 NZTC 59,471
Case J37 (1987) 9 NZTC 1,219
Church v CIR (1992) 14 NZTC 9,196 (HC)
Cross v CIR (1987) 9 NZTC 6,101 (CA)
Cross v CIR (1985) 7 NZTC 5,054 (HC)
Dobson v CIR (1987) 9 NZTC 6,025
Lowe v CIR (1981) 5 NZTC 61,006 (CA)
O'Toole v CIR (1985) 7 NZTC 5,045 (HC)
Paul Stephens Construction Limited v CIR (1990) 12 NZTC 7,192 (HC)
Smith v CIR (1987) 9 NZTC 6,045 (HC)
Smith v CIR (No 2) (1989) 11 NZTC 6,018 (CA)
Vuleta v CIR [1962] NZLR 325 (SC)
Wellington v CIR (1981) 5 NZTC 61,101 (HC)
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Other references
Hansard (14 September 1973) 386 NZPD 3653 and 3680–3681
Report of the Taxation Review Committee (October 1967)
Inland Revenue information release "Taxation of profits or gains from sales of land – Section 9 of the Land and Income Tax Amendment Act 1973 – Section 88AA of Principal Act" (November 1973)

APPENDIX – EXCLUSIONS FROM SS CB 12 AND CB 13

Income Tax Act 2007

A1. The exclusions to ss CB 12 and CB 13 are as follows:

CB 17 Residential exclusion from sections CB 12 and CB 13

Exclusion: developing or dividing land for residential use

(1) Sections CB 12 and CB 13 do not apply if—

(a) the work involved in the undertaking or scheme is to create or effect a development, division, or improvement; and

(b) the development, division, or improvement is for use in, and for the purposes of, the residing on the land of the person or any member of their family living with them.

Exclusion: dividing residential land

(2) Sections CB 12 and CB 13 do not apply if—

(a) the land is a lot that came out of a larger area of land that the person divided into 2 or more lots; and

(b) the larger area of land—

(i) was 4,500 square metres or less immediately before it was divided; and

(ii) was occupied by the person mainly as residential land for themselves and a member of their family living with them.

…

CB 20 Business exclusion from sections CB 12 and CB 13

Sections CB 12 and CB 13 do does not apply if—

(a) the work involved in the undertaking or scheme is to create or effect a development, division, or improvement; and

(b) the development, division, or improvement is for use in, and for the purposes of, the carrying on of a business by the person on the land; and

(c) the business does not consist of the undertaking or scheme.

…

CB 21 Farm land exclusion from sections CB 12 and CB 13

Exclusion

(1) Sections CB 12 and CB 13 do not apply if—

(a) the land is a lot resulting from the division of a larger area of land into 2 or more lots; and

(b) immediately before the land was divided, the larger area of land was occupied or used by the person, their spouse, civil union partner or de facto partner, or both of them, mainly for the purposes of a farming or agricultural business carried on by either or both of them; and

(c) the area and nature of the land disposed of mean that it is then capable of being worked as an economic unit as a farming or agricultural business; and

(d) the land was disposed of mainly for the purpose of using it in a farming or agricultural business.

Circumstances for purposes of subsection (1)(d)

(2) The circumstances of the disposal of the land are relevant to the decision on whether the land was disposed of mainly for the purpose of using it in a farming or agricultural business. The circumstances include—

(a) the consideration for the disposal of the land:

(b) current prices paid for land in that area:

(c) the terms of the disposal:

(d) a zoning or other classification relating to the land:

(e) the proximity of the land to any other land being used or developed for uses other than farming or agricultural uses.

…

CB 23 Investment exclusion from sections CB 12 and CB 13

Sections CB 12 and CB 13 do does not apply if—

(a) the work involved in the undertaking or scheme is to create or effect a development, division, or improvement; and

(b) the development, division, or improvement is for use in, and for the purposes of, the person's deriving from the land income of the kind described in section CC 1 (Land).

Classified Inland Revenue – Public

NEW LEGISLATION

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

ORDER IN COUNCIL

USE-OF-MONEY INTEREST RATES CHANGE

The use-of-money interest rates on underpayments and overpayments of taxes and duties have changed, in line with market interest rates. The new rates are:

- underpayment rate: 9.21% (previously 8.40%)
- overpayment rate: 2.63% (previously 1.75%).

The new rates will apply from 8 May 2015, the day after the due date for the third instalment of provisional tax paid by taxpayers with standard balance dates.

Rates are reviewed regularly to ensure they are in line with market interest rates. The new rates are consistent with the Reserve Bank floating first mortgage new customer housing rate and the 90-day bank bill rate.

The rates were changed by Order in Council on 30 March 2015.

Taxation (Use of Money Interest Rates) Amendment Regulations 2015 (2015/63)

Classified Inland Revenue – Public

ITEMS OF INTEREST

CHANGES TO FORMAT OF INLAND REVENUE LEGISLATION

The Parliamentary Counsel Office (PCO) has made a number of changes to the format of legislation and to the New Zealand Legislation website. The changes, which were made during the weekend of 11 April, affect Inland Revenue legislation published by the PCO in print and on the website.

The two principal changes are as follows:

- Shading is now used in amending legislation to indicate where whole blocks of text are to be inserted in other legislation, replacing the current use of quotation marks around these blocks.
- The page size of published legislation has been standardised to A4 and the text area for all legislation increased accordingly.

In addition, there are changes to the current format of legislation so the HTML format seen on the website screen reflects the PDF format used for printing.

Formulas in the Income Tax Act 2007

In particular, to ensure that formulas in legislation appear identically (and correctly) in both HTML and PDF formats, the PCO is requiring that formulas in the future be expressed as a single line. This change will be noticeable for users of the Income Tax Act 2007.

Previously, the following formula appeared in the Income Tax Act 2007 in the form of a fraction (with a numerator and a denominator) multiplied by another term:

$$\frac{\text{past expenditure}}{\text{total expenditure}} \times \text{amount on disposal}$$

The formula now appears in the following format:

$$(\text{past expenditure} \div \text{total expenditure}) \times \text{amount on disposal}$$

More details of the changes are provided at **www.pco.parliament.govt.nz/pco-quarterly.html**

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.

INTERPRETATION OF SECTION 113: THE COMMISSIONER'S ABILITY TO CORRECT ASSESSMENTS

Case	Westpac Securities NZ Ltd v Commissioner of Inland Revenue
Decision date	19 December 2014
Act(s)	Tax Administration Act 1994, Income Tax Act 2007
Keywords	Section 113, discretion, irrevocability, correct assessment

Summary

The Commissioner of Inland Revenue's ("the Commissioner") ability to exercise her discretion in s 113 of the Tax Administration Act 1994 ("TAA") is not limited to amendments made to correct an assessment previously in error. Section 113 can also be applied to amend an assessment that is not incorrect and substitute another more appropriate assessment. Also, the Court held that the fact that an election made by the taxpayer was irrevocable did not limit the Commissioner's ability to exercise s 113.

Case Impact Statement

This judgment confirms that the Commissioner's power to amend assessments in s 113 of the TAA is not limited by the "correctness" of the previous assessment; the Commissioner has a wide discretion to amend an existing assessment which may not be incorrect and substitute another more appropriate assessment. Further, the Court held that the irrevocability of elections in s IC 5(4) of the Income Tax Act 2007 ("ITA") did not preclude the Commissioner from exercising the s 113 discretion.

The judgment also indicates that in the exercise of the discretion the Commissioner may take into account factors such as that s 113 is not intended to be used by taxpayers as a way of circumventing the statutory disputes process or "gaming the system", the merits of the case, and the resources available to the Commissioner.

The Commissioner is currently considering the impact of this decision on her Standard Practice Statement (SPS 07/03) *Requests to amend assessments*. In the interim, the Commissioner will continue to apply SPS 07/03 having regard to this decision.

Facts

The plaintiffs were all members of the Westpac group of companies ("Westpac"). Four of the group's companies elected to offset losses against the income of Westpac Securities NZ Ltd and WestpacTrust Securities NZ Ltd, which resulted in the latter companies being unable to use foreign tax credits that subsequently became available to them.

Westpac applied to the Commissioner under s 113 of the TAA for the Commissioner to amend the assessments of the relevant companies so that the losses could be offset elsewhere.

The Commissioner declined the request on the basis that s IC 5(4) of the ITA provides that loss offset elections are irrevocable and that provision applied equally to Westpac and the Commissioner; and that Westpac's elections were legally valid options which had resulted in correct assessments and so did not fall under her s 113 power to correct. In making the latter decision, the Commissioner also relied on the distinction drawn in her Standard Practice Statement (SPS 07/03) between genuine errors and regretted choice and decided that Westpac's case was one of regretted choice.

Westpac applied for judicial review of that decision.

Decision

Section 113

Clifford J, referring to the dictionary definition of "correct" as meaning "free from error, true, accurate" or "in accordance with fact, truth, or reason" or "meeting the requirements of a particular situation", noted the concept of correctness was not necessarily a binary one. Clifford J concluded that, on a plain reading of s 113, the

Commissioner was not precluded from amending an assessment which was on one understanding correct to ensure it is nevertheless accurate or most appropriate for a particular situation.

Clifford J considered this analysis was confirmed when s 113 was viewed in the context of the TAA and ITA as a whole. He reviewed the purpose of the self-assessment regime, the Commissioner's care and management provisions in ss 6 and 6A of the TAA, the disputes process and the circumstances in which the Commissioner may amend an assessment in ss 113A, 113B and 113C. He concluded from this review that the Commissioner's power to amend assessments was Parliament's recognition of the competing interests in a self-assessment tax system: that while taxpayers were obliged to self-assess correctly, amendments may still be necessary to ensure the integrity of the tax system is upheld.

Finally, Clifford J examined case law and the legislative history of s 113, noting that its predecessor (s 23 of the Income Tax Act 1976) provided the relevant power was to make all "alterations in or additions to" an assessment. The essence of the provision had remained the same and the previous authority on the interpretation of s 23 remained applicable. He noted that the Court of Appeal had emphasised the broad scope of s 23 and held that the Commissioner was not precluded from using s 113 to amend an assessment where there are a number of correct tax positions (*Wire Supplies Ltd v Commissioner of Inland Revenue* [2007] NZCA 224, [2007] 3 NZLR 458). Equally, Wylie J had noted the unfettered nature of the s 113 discretion (*Arai Korp Ltd v Commissioner of Inland Revenue* [2013] NZHC 958, (2013) 26 NZTC 21-014).

Taken together, Clifford J held that neither the authorities, nor the wording or purpose of s 113, required an amendment only where an incorrect tax position was taken. Further, he considered the integrity of the tax system would be undermined if the Commissioner was precluded from looking behind a correct tax position to consider whether the assessment needs correcting. It might be the case that allowing a taxpayer to amend a self-assessment was more consistent with the policy underpinnings of the legislation.

Accordingly, Clifford J held that the s 113 power was not limited in the way the Commissioner had argued. However, he also held it was not limited in the way Westpac had argued: that is, between a situation where the taxpayer makes a choice that with the benefit of hindsight is demonstrated to be less advantageous to an alternative position, and an error that would have been apparent at the time to a taxpayer with a proper appreciation of the relevant facts and law. His Honour considered that distinction would be a factor relevant to whether the Commissioner would exercise her discretion, rather than a limitation on the power itself. Relevant factors would also include the fact that s 113 is not intended to be used as a way of circumventing the disputes process, the merits of the case and the resources available to the Commissioner. Clifford J indicated that the fact that Westpac was a well-resourced taxpayer was also a relevant consideration.

Section IC 5(4)

Clifford J accepted Westpac's argument that s IC 5(4) of the ITA applied only to the taxpayer and not the Commissioner. His Honour agreed that the section was there to clarify that although the form of an election is a unilateral choice by one taxpayer, it would be impractical if that taxpayer could unilaterally revoke its choice as the election affected two taxpayers. However, that consideration did not apply to preclude the Commissioner from exercising her discretion under s 113.

Further, it would be impractical given the extensive number of situations in which the Commissioner may need to exercise her s 113 power, including resolving a dispute with a taxpayer, for her to be precluded in resolving that dispute from amending an irrevocable election.

Conclusion

Clifford J held that the Commissioner may consider whether to exercise her discretion under s 113 to correct Westpac's assessments in the manner requested by Westpac. However, whether she would exercise her discretionary power in that way was a matter for her and outside the scope of the Court's judgment.

ADVISORY FEES FACILITATE INBOUND TOUR OPERATIONS AND ATTRACT GST AT THE STANDARD RATE

Case	ID Tours New Zealand Limited v Commissioner of Inland Revenue
Decision date	16 March 2015
Act(s)	Goods and Services Tax Act 1985
Keywords	Agent, domestic tourism products, facilitation, packaging, zero-rating

Summary

This was an appeal from the decision of the Taxation Review Authority ("TRA") that found advisory services supplied by the appellant to overseas operators were chargeable with tax at the standard rate under s 8(1) of the Goods and Services Tax Act 1985 ("the Act"). The appeal was dismissed.

Impact of decision

In determining whether goods and services tax ("GST") applies to a transaction, the focus is on the nature of supply and the contractual relationships actually entered into and carried out.

Facilitation services provided by a registered person in s 8(2B) of the Act include services that are included in or form part of the packaging and selling process. Packaging involves the action of putting things (domestic tourism products and services) together for a particular purpose (sale to overseas operators).

Facts

ID Tours ("the appellant") is described as a "Ground Handler" and a destination management company that provides advisory tourism services to cruise lines, incentive houses and a UK travel agent.

This decision concerns the appellant's appeal of the TRA's finding that it facilitated inbound tour operations for the purposes of s 8(2B) of the Act.

The appellant also appeals the TRA's finding that it supplied the advisory tourism services under contractual arrangements to overseas operators and that those services were received in New Zealand by another person so that, pursuant to s 11A(2) of the Act, zero rating does not apply.

The practical effect of the TRA's findings was that the appellant's services are chargeable for GST.

Decision

The appeal was dismissed. The High Court found that s 8(2B) of the Act applied to the appellant's advisory services, which were therefore chargeable with GST at the standard rate under s 8(1) of the Act. As s 8(2B) of the Act applied, it was unnecessary to consider the application of s 11A(2).

Whether the TRA was wrong in its finding under s 8(2B) of the Act

The High Court noted that it was open to the TRA to find that the appellant was not an agent of the overseas tour operators. The Court looked to the actual arrangements entered into by the parties and determined that the appellant formed two separate contractual arrangements, one with the overseas operator and another with the local suppliers.

As the Court found that the appellant was not an agent, it was necessary to consider whether its services consist of facilitation of inbound tour operations under s 8(2B) of the Act. This required an assessment of whether the appellant's business of providing advisory and "on the ground" services amounted to packaging one or more domestic tourism products and services for the purposes of the definition in s 8(2F).

The Court found that the prima facie meaning of facilitation of inbound tour operations is the provision of services in the process of or in the act of organising one or more domestic tourism products or services in New Zealand into a set of interdependent or related objects that are viewed as a unit.

The Court found that the TRA was correct to find the appellant's advisory services are an integral part of the process of packaging domestic tourism products and selling them to overseas operators. The High Court found that for the purposes of ss 8(2B) and 8(2F) of the Act, the appellant's advisory services consist of facilitation of inbound tour operations and are chargeable with GST.

Other arguments

The High Court also considered additional issues brought by the appeal.

Corroboration and creditability of evidence

1. The appellant submitted that the TRA failed to provide reasons for not accepting the appellant's evidence. The TRA did not make any findings of credibility in relation to the appellant's evidence. The High Court noted that there is no requirement for the TRA to make express findings of witness credibility and none were required to the extent that the appellant's factual witness gave opinions as to the legal position.
2. The appellant submitted that the TRA made incorrect findings of fact due to the absence of corroborative evidence provided by the appellant and the appellant should have been warned that it would need to provide evidence from overseas operators and local suppliers. The High Court found that there was nothing in the TRA's decision that indicated it would have reached a different conclusion had the evidence been provided. Ultimately the onus was on the appellant to demonstrate that the services should be zero-rated, which includes providing the evidence it deems helpful.
3. The High Court found that the appellant's submission that the TRA failed to provide reasons for not accepting the appellant's evidence is incorrect.

Errors on record

1. The appellant contended that the TRA incorrectly recorded its concession at [60] of the decision under appeal. The appellant raised this point on appeal because it says it goes to the question of whether the appellant is an agent of the overseas operator.

2. The High Court found that the concession as recorded at [60] did not impact on the TRA's consideration of whether s 8(2B) of the Act applied. The High Court also noted that the TRA had already found that no agency relationship existed between the appellant and any of the overseas operators.

Errors of fact

1. The appellant acknowledged that the errors of fact it alleged occurred are immaterial, but contended that their number may indicate the TRA reached conclusions not supported by the evidence.
2. The High Court found that the facts the appellant says are erroneous appear to have been summarised generally by the TRA for the convenience of the reader without distorting the essence of the evidence.

NO JURISDICTION TO DETERMINE PROCEEDING WHERE DISPUTES PROCEDURE NOT COMPLETED

Case	TRA 017/12; [2015] NZTRA 02
Decision date	12 March 2015
Act(s)	Tax Administration Act 1994
Keywords	Strike out, jurisdiction

Summary

This was a decision of the Taxation Review Authority ("TRA") striking out the disputant's Notice of Claim ("NOC") on the grounds that the disputes procedure under Part 4A of the Tax Administration Act 1994 ("TAA") had not been completed. Therefore, the TRA lacked jurisdiction to hear and determine the proceeding.

Impact of decision

This decision reaffirms the decision in *Allen v Commissioner of Inland Revenue* [2006] 3 NZLR 1 that s 138H of the TAA provides a procedural mechanism for removing from the TRA proceedings that have been improperly commenced because of noncompliance with s 138B of the TAA.

Facts

The proceeding concerned an application made by the Commissioner of Inland Revenue ("the Commissioner") to strike out the disputant's amended NOC. The application was made on the grounds that the TRA lacked the jurisdiction to hear and determine the proceeding as the disputes procedure under Part 4A of the TAA had not been completed.

The underlying dispute involves a goods and services tax ("GST") refund claimed by the disputant for the period ended 30 July 2009 ("the GST period"). The Commissioner made an assessment on 23 November 2010 disallowing the input credit claimed. On 20 June 2012, the Commissioner issued an amended assessment ("Notice of Assessment") under s 113 of the TAA. The assessment was made pursuant to s 89C(eb) of the TAA, which provides that where the Commissioner has reasonable grounds to believe the taxpayer has been involved in fraudulent activity, the Commissioner may make an assessment without first issuing a Notice of Proposed Adjustment ("NOPA").

The disputant issued a NOPA, dated 23 September 2012 but received by the Commissioner on 3 September 2012. The Commissioner issued a Notice of Response ("NOR") on 1 November 2012 rejecting the disputant's NOPA.

At the same time as issuing the NOPA, the disputant filed a NOC in the TRA dated August 2012, purporting to challenge the assessment. The amended NOC was filed following a hearing held on 20 December 2012. The Commissioner filed the present application to strike out this claim on 7 March 2013.

The disputant then filed judicial review proceedings in the High Court seeking judicial review of the Commissioner's assessment of the GST period. The Commissioner filed an appearance and objection to jurisdiction and in the alternative, an application to strike out the causes of action against her. The High Court dismissed the causes of action against the Commissioner on the basis that s 109 of the TAA applied and each cause of action could be dealt with in the statutory disputes and challenge process ("jurisdiction decision").

The disputant attempted to appeal the jurisdiction decision but the application for an extension of time to appeal was dismissed by the Court of Appeal in September 2014 on the basis that the proposed appeal was hopeless and another statutory remedy was available. The Court of Appeal concluded it was not in the interests of justice to extend the time to appeal.

The disputant also had a damages claim running concurrently with the above proceedings. On 6 July 2012, the disputant filed a Statement of Claim ("SOC") seeking damages and/or compensation of $5,113,810.72, as well as an application for summary judgment seeking judgment in the sum of $594,210.48 for withheld GST refunds.

The summary judgment application was dismissed in April 2013 by the High Court. The disputant then filed an amended SOC, which included a fourth cause of action purporting to be a challenge under Part 8A of the TAA to the Commissioner's Notice of Assessment. The Commissioner made an application to strike out this cause

of action and in a judgment delivered in July 2014, the Associate Judge granted the application noting that the disputes procedure had not been completed.

The disputant applied to review the strike-out decision and in December 2014 the High Court held the Associate Judge was right to strike out the cause of action.

Decision

The TRA struck out the challenge proceeding.

Lack of jurisdiction

Section 138H of the TAA provides that the Commissioner may apply to strike out a challenge commenced by the disputant if the disputant has failed to comply with s 89M or s 138B of the TAA.

The Commissioner argued that completion of the disputes procedure under Part 4A is required before a challenge under Part 8A can be commenced. The statutory disputes process has not been completed and so the TRA lacks jurisdiction to hear and determine the claim. Both parties filed Statements of Position, following which the proper step was to refer these and supporting evidence to the Disputes Review Unit ("DRU").

The dispute had not yet been referred to the DRU. There are currently three similar disputes underway concerning the disputant's GST returns, and the Commissioner believes they should be considered together. This process has been delayed by the various other proceedings in the High Court concerning these disputes.

Section 138B of the TAA sets out the circumstances in which an assessment can be challenged. The disputant relied upon s 138B(1) which sets out the disputes process where the Commissioner has proposed an adjustment. It said that by amending the assessment the Commissioner had proposed an adjustment, and further argued that in the judicial review proceeding the High Court had confirmed that s 138B(1) was the provision under which it should bring its challenge.

The Commissioner relied on s 138B(3) of the TAA, which deals with situations where the disputant has proposed the adjustment. She disagreed with the disputant's interpretation of the judicial review proceeding, and relied on *Allen v Commissioner of Inland Revenue* [2006] 3 NZLR 1 as authority that the reference to an "adjustment proposed by the Commissioner" in s 138B(1) was a reference to a NOPA.

Judge Sinclair agreed with the Commissioner and found the disputant initiated proceedings. While the Commissioner issued a Notice of Assessment, this could not be held to be a NOPA for the purposes of s 138B of the TAA. The disputant then issued a NOPA in response to the Commissioner's Notice of Assessment and this initiated proceedings. Section 138B(3) was held to be the applicable subsection.

If the taxpayer has initiated proceedings, and the DRU finds in favour of the Commissioner, a challenge notice pursuant to s 89P of the TAA is issued. Part 8A sets out the process by which a taxpayer may challenge an assessment. To engage in that process the taxpayer must first meet the requirements under s 138B.

Judge Sinclair found that, as the DRU stage had not been completed and no challenge notice issued, the disputes procedure under Part 4A of the TAA had not been completed and the challenge procedure under Part 8A (s 138B) could not be invoked.

Abuse of process

The Commissioner also submitted that the proceeding was an abuse of process, as the prerequisites for commencing a challenge proceeding had not been met. The disputant had raised the same issues in proceedings before the High Court, and been directed that it had to complete the statutory disputes process before it could issue a challenge.

Judge Sinclair agreed and held the proceeding to be an abuse of process.

Res judicata

The disputant contended that the issue of which subsection of s 138B of the TAA to apply, was determined in the judicial review proceedings, and so it was res judicata or alternatively the Commissioner was estopped from raising the issue.

Judge Sinclair found the judicial review proceedings did not specifically consider the application of s 138B(1) or apply it to the facts, and so concluded there was no issue with res judicata or estoppel.

Deemed acceptance

The disputant alleged the Commissioner's NOR was issued out of time and so the criteria of s 138B(3) of the TAA could not be met.

Her Honour stated that this matter had been dealt with in the judicial review proceeding. The High Court and Court of Appeal both concluded that any disagreement about the date each party issued its dispute document is a disputed fact that could be determined in the statutory dispute and challenge procedures.

Other arguments

The disputant also contended that the Commissioner had acted ultra vires and in breach of the New Zealand Bill of Rights Act 1990. Her Honour found those issues were not

relevant to the present application, which turned solely on whether s 138B of the TAA had been complied with so that the challenge procedure had been properly commenced.

There would be no prejudice to the disputant in granting the Commissioner's application. Once the proper disputes procedure has been completed the disputant will still have the opportunity to raise all the substantive issues it wants to before a validly convened hearing authority.

Delay was an irrelevant consideration to the current proceeding, as delay does not affect jurisdiction.

COURT OF APPEAL UPHOLDS HIGH COURT'S DECISION GRANTING COMMISSIONER'S TRANSFER APPLICATION

Case	Kensington Developments Limited (in Receivership) v Commissioner of Inland Revenue
Decision date	11 March 2015
Act(s)	Tax Administration Act 1994
Keywords	*Erris*, s 138N(2), transfer, precedential value, complexity, likelihood of appeal

Summary

The Court of Appeal upheld the High Court's decision granting the Commissioner of Inland Revenue's ("the Commissioner's") application to transfer the challenge proceeding filed by Kensington Developments Limited's (in receivership) ("Kensington") in the Taxation Review Authority ("TRA") to the High Court.

Impact of decision

This decision endorsed the factors set out in *Commissioner of Inland Revenue v Erris Promotions* [2003] 1 NZLR 506 (CA) ("*Erris*"), which are required to be considered by the Court in determining whether to grant a transfer application under s 138N of the Tax Administration Act 1994 ("TAA"). This decision is also authority that the important precedential value of a proceeding alone can be determinative in favour of granting an application for transfer.

Facts

Kensington has been in receivership since 1994 with Mr John Russell ("Mr Russell") as the receiver.

Kensington has claimed interest expenditure deductions for a purported loan from BNZ that has never been paid. It has also claimed deductions for interest expenditure in respect of a debenture held by Downsview Finance Ltd. Mr Russell and his wife are the beneficial owners of those shares.

Kensington has also acquired debentures over 14 companies, with Mr Russell being the receiver of each of those companies. Many of these companies have claimed similar interest expenditure deductions to Kensington. The challenge proceeding filed by Kensington, which is the subject of the Commissioner's transfer application, concerns only the losses claimed by Kensington. These losses total $15,756,946.76.

The Commissioner's position in the challenge proceeding is that the interest expenses have not been suffered by Kensington and that the deductions should be denied as part of a tax avoidance arrangement.

In April 2013, the Commissioner's application to transfer the challenge proceeding filed by Kensington in the TRA to the High Court was successful.

Kensington has appealed the High Court's decision granting the Commissioner's transfer application.

Decision

Approach on appeal

The Court began its decision by stating that the appeal was a general appeal and that the approach described by the Supreme Court in *Austin, Nichols & Co Inc v Stichting Lodestar* [2007] NZSC 103, [2008] 2 NZLR 141 at [4] applies. This is that the appellant bears the onus of satisfying the appeal court that it should differ from the decision under appeal.

Presumption that the taxpayer's choice of hearing authority should prevail

Kensington argued that in considering an application to transfer a challenge before the TRA to the High Court, the Court is obliged to apply a presumption that the taxpayer's choice of hearing authority should prevail, particularly when that choice is the TRA. Kensington acknowledged that the principles identified in *Erris* were against it on this point but Kensington said that the discussion in *Erris* was obiter and asked the Court of Appeal to clarify the law.

Kensington argued the existence of the presumption emerges from the legislative history and the existing scheme of the legislation. In particular, it referred the Court to the objections regime, the Income Tax Act 1976 and the TAA in support of its submission. Kensington argued that the use of language in s 136(4) of the TAA and in particular the words "general or public importance" and "extraordinary difficulty" convey Parliamentary intent that the TRA is the usual first instance hearing authority, with the High Court reserved for truly important or extraordinary cases.

The Court of Appeal was satisfied that the High Court Judge applied the correct test and that the *Erris* principles gave proper effect to the statutory provisions. The Court

of Appeal stated that while the factors set out in s 136(4) of the TAA may be relevant to a transfer decision in a particular case, the High Court held that those factors do not create a presumption that the hearing should be in the TRA. Further, the Court of Appeal held that there is a clear indication that the Court's discretion in respect of applications under s 138N was not intended to be constrained by the considerations listed in s 136(4), given the absence of a similar provision in Part 8.

Accordingly, the Court of Appeal did not see any merit in Kensington's arguments regarding a presumption in favour of the TRA over the High Court.

No grounds made out for transfer

Kensington argued that whether or not the presumption it argued applied, there were no proper grounds made out for the transfer. The Court of Appeal having heard arguments considered that the Judge was correct to order transfer. When making its decision, the Court considered the following factors.

Precedential value

The Court of Appeal stated that the determinative consideration in reaching the above view is the precedent that a decision in the challenge proceeding will establish. The Court of Appeal noted that the Commissioner is currently involved in two other disputes and has active investigations in progress that raise identical issues to the challenge that is the subject of the transfer application. These disputes and investigations all involve an insolvent taxpayer company in receivership (with Mr Russell as the receiver). The company has continued to claim deductions for interest owing under a debenture held by a company of which Mr Russell is a director and/or receiver. The taxpayer company has been in receivership for a period exceeding 10 years and has during that time accrued millions of dollars' worth of purported losses. In each of these cases, the Commissioner is alleging that the taxpayer company entered into a tax avoidance arrangement, which is void as against her pursuant to s BG 1 of the Income Tax Act 2004.

Kensington argued that the precedent the decision will establish carries little weight since Mr Russell does not accept that the finding will dispose of the other disputes and investigations. The Court of Appeal considered that a decision from the High Court in the challenge proceeding would be binding on the TRA in future disputes that involve identical issues. Further, the Court of Appeal held that it would be binding on other similarly positioned taxpayers and would be a significant precedent even if Mr Russell chooses to argue otherwise.

Complexity

The Court of Appeal agreed with the High Court Judge that an additional reason for transfer is the complexity of the proceeding. The Court of Appeal also agreed with the High Court's assessment that the challenge case is of moderate complexity. It was held that even though that area of law may be relatively settled, its application to new facts may not be straightforward. No weight was attached to the Commissioner's contention that it is significant that the court hearing will have to consider the duties and best practice of a receiver under the Receivership Act 1993 because this bears upon the commerciality of the arrangements. Although the Court of Appeal recognised that the law in connection with the duties and obligations of receivers is traditionally administered in the High Court, the Court of Appeal expected that the TRA would have no difficulty interpreting the statutory framework and body of case law that has emerged since the Receivership Act came into force.

Accordingly, the Court of Appeal agreed with the High Court that the moderate complexity weighed in favour of transfer to the High Court but could not on its own be decisive.

Vendetta

The Judge in the High Court considered that the administrative law challenges mounted by Kensington weighed in favour of transfer to the High Court. The Court of Appeal noted that counsel for Kensington says it would abandon those challenges if it meant the difference to a transfer decision. The Court of Appeal stated that although allegations including vendetta, abuse of power and actions amounting to fraud on the taxpayer may weigh in favour of transfer to the High Court in some cases, in this case it was not a determinative factor. The Court of Appeal did not consider the issue further in light of Kensington's indication.

Delay

Kensington argued that the High Court Judge was wrong to view delay in applying for a transfer as a neutral factor. However, it could not show any particular prejudice arising from the delay, pointing only to the fact that, until the application, Kensington had been preparing on the basis that the hearing would be in the TRA. The Court of Appeal considered this did not amount to prejudice. In the absence of prejudice attributable to delay, the Court of Appeal held that the issue of delay was irrelevant to this issue of transfer. Further, the Court of Appeal noted that the Commissioner gave an explanation for the delay, which helped to moderate the significance of the issue.

Likelihood of appeal

Finally, the Court of Appeal agreed with the High Court that the likelihood of appeal is relevant to consideration of the application. The Court of Appeal noted that as stated in *Erris*, even if the TRA can provide an earlier hearing date, this would not necessarily mean less delay in final resolution where appeal is likely, as starting in the TRA adds a further layer of appeal. The Court of Appeal considered that appeal is very likely in the challenge proceeding as the matters at issue are significant for the parties, particularly given the extent of similar disputes involving the Commissioner and companies controlled by Mr Russell.

COMMISSIONER SUCCESSFUL IN ASSOCIATING TWO COMPANIES UNDER SECTION 2A(1) OF THE GOODS AND SERVICES TAX ACT 1985

Case	[2015] NZTRA 01; TRA 02/10
Decision date	2 March 2015
Act(s)	Goods and Services Tax Act 1985
Keywords	Associated persons, s 2A(1), control, “any other means whatsoever”, legal control, factual control, s 46, disputable decision, tax avoidance, s 76

Summary

The Taxation Review Authority (“TRA”) held that the disputant and the vendor in a secondhand property transaction were associated persons under s 2A(1)(a)(i) of the Goods and Services Tax Act 1985 (“GST Act”). In the alternative, the TRA found the disputant had entered into a tax avoidance arrangement that was void as against the Commissioner of Inland Revenue (“the Commissioner”) under s 76.

Facts

The proceeding concerned assessments made by the Commissioner reversing goods and services tax (“GST”) input deductions claimed by Disputant Ltd (“Disputant”) arising from the purchase of property from X Land Holdings (“X”) for the GST periods ending 31 January 2007, 30 September 2007 and 31 January 2008.

In February 2006, Disputant and X entered into an agreement for the purchase and sale of property for $4,557,000.00 (including GST). By agreement, Disputant was to pay a $50,000.00 deposit to X with the balance for the land paid by nine instalment payments of $500,000.00 and a final payment of $7,000.00.

The Commissioner declined the GST inputs sought by Disputant under s 46 of the GST Act pending an investigation. Disputant issued a Notice of Proposed Adjustment (“NOPA”) in respect of the Commissioner’s decision to withhold the GST inputs and the Commissioner issued a Notice of Response in response. Upon completion of the disputes process the Commissioner made assessments for unpaid GST totalling $505,555.60 with shortfall penalties of $250,000.00.

The assessments were made on the basis that Disputant and X were associated persons under s 2A(1)(a)(iii) of the GST Act and alternatively, that the input credits claimed by Disputant were part of a tax avoidance arrangement that is void as against the Commissioner under s 76 of the GST Act.

Decision overview

The TRA decided in the Commissioner’s favour finding that Disputant and X are associated persons under s 2A(1)(a)(i) of the GST Act by the binding High Court case of *Concepts 124*. In addition, the TRA upheld the Commissioner’s alternative argument that the transaction constituted a tax avoidance arrangement under s 76 of the GST Act and was void as against the Commissioner.

However, the TRA did not find that Disputant and X are associated persons under s 2A(1)(a)(iii) of the GST Act—namely that Disputant and X were not associated by “any other means of control whatsoever”.

In respect of the arguments raised by Disputant, the TRA:

1. found that the Commissioner did not unlawfully withhold the GST refunds sought by Disputant and that the decision to withhold the GST input credits was in accordance with s 46 of the GST Act;
2. upheld the Commissioner’s position that the NOPA in respect of the GST return ending 31 January 2007 was received outside of the statutory time limit and that Disputant’s explanation for the delay in issuing a late NOPA was without merit;
3. did not find that the Commissioner’s assessments were invalidated for the various administrative arguments detailed by Disputant, including that the assessments were made without proper delegated authority, were in breach of s 6 of the TAA or New Zealand Bill of Rights Act, or that the Commissioner had a vendetta against Mr R.

These findings are discussed in detail below.

Discussion

Associated persons – ss 2A(1)(a)(i) and/or 2A(1)(a)(iii) of the GST Act

The Commissioner's principal argument was that Disputant and X were associated persons under s 2A(1)(a)(iii) of the GST Act. The TRA considered Disputant's argument that "association" under s 2A(1)(a)(iii) refers to legal control and that since each party had different legal ownership they were not associated under subsection (1)(a)(iii). The Commissioner submitted that even though X was legally controlled by shareholders based in the United States, the evidence showed that major decisions relating to the property were made by Mr R, and on that basis it was appropriate to find that Mr R had factual control of X. The Commissioner took a similar approach with Disputant, contending that while it appeared the Crown had legal control of Disputant, the Crown was unlikely to have any knowledge of Disputant and could not be said to have had any real control over Disputant.

The TRA did not uphold the Commissioner's argument and found that "control by other means" in s 2A(1)(a)(iii) does not include "factual control" but includes the other forms of legal control discussed in *Concepts 124*.

The TRA then considered the Commissioner's argument made on the final day of oral submissions that Disputant and X are associated under s 2A(1)(a)(i) of the GST Act due to a 100% commonality of voting interests between Disputant and X. This argument was made following the High Court's decision in *Concepts 124* where Clifford J did not distinguish between shares held directly or in a trust capacity when considering whether two companies are associated by commonality of voting interests. Clifford J held that as a matter of basic company law, a share is held by the person registered as its holder for the time being in the company's share register and that company law requires companies to ignore trust interests. The TRA held that *Concepts 124* was binding upon it and on that basis the TRA found that Disputant and X were associated notwithstanding the fact that Mr R argued the shares of Disputant were held on trust for the benefit of another company.

Tax avoidance arrangement – s 76, GST Act

The Commissioner's alternative argument was that the input tax credits claimed by Disputant were part of a tax avoidance arrangement that is void as against the Commissioner under s 76 of the GST Act. As a preliminary issue, the TRA accepted that the analysis undertaken in invoking s 76 of the GST Act would meet the requirements of the "four-step" analysis outlined in her Policy Statement on s 99 of the Income Tax Act 1976 ("ITA 1976"). However, the TRA agreed that the Policy Statement is applicable to s 99 of the ITA 1976 and the Privy Council's findings in *O'Neil v the Commissioner of Inland Revenue* (2001) 20 NZTC 17,051 and had no direct relevance in this proceeding.

The TRA was satisfied Disputant had entered into an arrangement. The TRA went on to consider whether there was any tax avoidance as defined in s 76(8)(c) of the GST Act. The TRA was satisfied that the increase in entitlement to a GST refund resulting from the arrangement satisfied the definition of "tax avoidance" in s 76(8)(c).

When considering whether tax avoidance was the purpose of the transaction, the TRA found that the various arguments made by Mr R were not substantiated and were inconsistent. The TRA held that the test to determine whether the purpose of a transaction is avoidance is objective and that "viewed objectively, [Disputant] has not given a cogent explanation to support a non-tax purpose of the arrangement … Put another way, 'but for' the arrangement no input tax credits would have been available to [Disputant]" (at [117]).

The TRA then considered whether the use of ss 2A(1)(a) and 3A(3) of the GST Act were within the contemplation of Parliament. The TRA observed that Parliament does recognise that claims for large input tax credits are made by registered purchasers stemming from the purchase of secondhand goods from non-registered vendors. Further, the TRA noted in some cases, the secondhand goods were being sold to an associated person principally to gain the input tax credit and to address this concern, Parliament had enacted ss 2A(1)(a) and 3A(3) of the GST Act to limit the credit available in relation to supplies of secondhand goods between associated parties.

The TRA agreed with the Commissioner that Parliament would not have contemplated that an input tax credit would be available on the sale of the property where the parties have gone to such efforts to minimise their formal association, and where a high degree of contrivance, pretence and artificiality is evident in the transaction. In support of this finding, the TRA's reasons included the ownership of both Disputant and X involved a complicated company structure, the fact that the transaction was not settled in accordance with the documentation and the fact that the day before the transaction occurred, Disputant and X swapped directors and Disputant had not provided any reason for why that step was taken. In the TRA's view, the only inference to be drawn was that it was done to lessen the association between the two companies.

Finally, the TRA agreed with the Commissioner that the purpose of tax avoidance was not merely incidental. Rather, the TRA was of the view on the evidence that the arrangement was entered into for the sole purpose of gaining access to input tax credits on the transfer of the property from X to Disputant.

Unlawful withholding of GST credits – s 46, GST Act

Mr R on behalf of Disputant submitted that the Commissioner's decision to withhold GST refunds due to Disputant contravened s 46 of the GST Act for a number of reasons.

In response to Disputant's argument that a s 46 notice is required to be issued by the Commissioner if she is not satisfied with a return whether there is a refund or not, the TRA held that s 46 is clearly intended to apply where a refund is sought and not otherwise.

Disputant argued that requirements under s 46 of the GST Act place a time limit on the Commissioner's ability to exercise her discretion under that section. The TRA agreed with the Commissioner and held that a decision by the Commissioner to withhold payment of a refund under s 46 is not a disputable decision.

Disputant argued that the Commissioner has chosen an arbitrary figure and because that figure was surpassed, the refund was automatically refused (and a s 46 letter issued). In these circumstances, Disputant argued that it was not a situation where the Commissioner (for the purposes of s 46(2)) had not been satisfied with the return. The TRA accepted evidence of the Commissioner's officer that there was no process in place for the automatic generation of s 46 notices.

Disputant argued that the Commissioner could have paid the refund and carried out any investigations subsequently. The TRA agreed with the Commissioner that Disputant's approach was at odds with the Supreme Court's view in *Contract Pacific Limited v Commissioner of Inland Revenue* [2010] NZSC 136. Accordingly, the TRA found that once notice is given by the Commissioner to investigate a particular GST return, the Commissioner is not required to pay any refund until the point in time stipulated in s 46(1)(b) of the GST Act.

Assessments invalid for administrative reasons

Disputant raised a number of administrative arguments as to why the assessments made by the Commissioner were invalid. The TRA considered each and made the following findings:

1. Mr R's allegations of vendetta were not upheld. The TRA considered that Mr R's submission of Judge Willy's comments in *Case U11* (1999) 19 NZTC 9,100 that "the feuding must stop" had no relevance to this proceeding. Further, the TRA considered that the TRA was not the appropriate forum to raise allegations of vendetta. The TRA held that if Disputant wished to pursue such allegations, the appropriate procedure is by way of judicial review in the High Court.
2. The Commissioner's decisions were made with delegated authority, notwithstanding that the authorised delegation holder did not conduct the entire investigation and associated consultation. The TRA relied upon the comments of Collins J in *Accountants First Limited v Commissioner of Inland Revenue* [2014] NZHC 2446 at [63] in coming to that view.
3. The TRA did not find that the Commissioner's actions were in breach of either s 6 of the TAA or the New Zealand Bill of Rights Act 1990.

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