

TAX INFORMATION

Bulletin

CONTENTS

- 1 In summary
- 3 Binding rulings
 - Public rulings BR Pub 15/04–15/09: Income tax – Interest deductibility – *Roberts and Smith* – Borrowing to replace and repay amounts invested in a business or other income-earning activity
- 26 New legislation
 - Order in Council**
 - Privacy (Information Sharing Agreement Between Inland Revenue and New Zealand Police) Amendment Order 2015
 - Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015
- 34 Legislation and determinations
 - CPI Adjustment 15/01 for Determination DET 09/02: Standard-cost household service for childcare providers
 - CPI Adjustment 15/02 for Determination DET 05/03: Standard-cost household service for boarding service providers
 - Special Determination S35: Valuation of Shares issued by Bank following a conversion event
 - National average market values of specified livestock determination 2015
- 39 Legal decisions – case notes
 - Disputant’s application for filing challenge out of time declined
 - High Court strikes out judicial review, finding it to be an abuse of process
 - TRA considers it has no jurisdiction to consider GST periods
 - Notice of defence not necessary when filing an application to strike out

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

Public rulings BR Pub 15/04–15/09: Income tax – Interest deductibility – *Roberts and Smith* – Borrowing to replace and repay amounts invested in a business or other income-earning activity

3

The six public rulings consider the deductibility of interest in certain situations where a partnership or taxpayer borrows funds which are used to replace and repay existing funding. The existing funding must have been used in the business or other income-earning activity, and have been deductible. The rulings mostly concern the application of the replacement and repayment principle established in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380, although one of the rulings considers interest deductibility more generally (in respect of borrowing to make a subvention payment). The public rulings are re-issues of existing rulings that expire on 24 May 2015.

New legislation

Order in Council

Privacy (Information Sharing Agreement Between Inland Revenue and New Zealand Police) Amendment Order 2015

26

The Privacy (Information Sharing Agreement Between Inland Revenue and New Zealand Police) Amendment Order 2015 amends an existing information sharing agreement between Inland Revenue and the New Zealand Police.

Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015

27

The new Act amends the KiwiSaver Act 2006 and the Income Tax Act 2007. It allows eligible KiwiSaver members to withdraw their member tax credits when purchasing a new home, and corrects errors in the tax, social policy and KiwiSaver treatment of income replacement payments paid under the Veterans' Support Act 2014.

Legislation and determinations

CPI Adjustment 15/01 for Determination DET 09/02: Standard-cost household service for childcare providers

34

Inland Revenue advises that, for the 2015 income year, the variable standard-cost component and the administration and record-keeping fixed standard-cost components have been confirmed.

CPI Adjustment 15/02 for Determination DET 05/03: Standard-cost household service for boarding service providers

34

Inland Revenue advises that the weekly standard-cost component for the 2015 income year has been confirmed.

Special Determination S35: Valuation of Shares issued by Bank following a conversion event

35

This determination relates to a funding transaction involving the issue of Notes by Bank to Issuer. The Notes will contain a conversion mechanism, to allow them to be recognised as Additional Tier 1 capital for the purposes of the Reserve Bank of New Zealand frameworks relating to the capital adequacy of banks. This determination applies when shares are issued by Bank following a Trigger Event, to determine the value of the shares for the purposes of the financial arrangement rules.

National average market values of specified livestock determination 2015

37

This determination sets the national average market values to apply to specified livestock on hand at the end of the 2014–2015 income year.

Legal decisions – case notes

Disputant's application for filing challenge out of time declined

39

This is a decision of the Taxation Review Authority declining the disputant's application for an extension of time for filing challenge proceedings in relation to default assessments made by the Commissioner of Inland Revenue.

High Court strikes out judicial review, finding it to be an abuse of process

40

The High Court struck out John George Russell's application for judicial review of the Commissioner of Inland Revenue's decision declining his payment proposals.

TRA considers it has no jurisdiction to consider GST periods

42

The Taxation Review Authority held that only three goods and services tax periods were properly before it.

Notice of defence not necessary when filing an application to strike out

43

This was a decision of the Taxation Review Authority ("TRA") dismissing the disputant's Notice of Appearance under Protest to Jurisdiction, finding the TRA had jurisdiction to hear the Commissioner of Inland Revenue's strike-out application even though no Notice of Defence had been filed.

BINDING RULINGS

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

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

PUBLIC RULINGS BR PUB 15/04–15/09: INCOME TAX – INTEREST DEDUCTIBILITY – *ROBERTS AND SMITH* – BORROWING TO REPLACE AND REPAY AMOUNTS INVESTED IN A BUSINESS OR OTHER INCOME-EARNING ACTIVITY

This is a reissue of BR Pub 10/14–10/19. For more information about earlier publications of these Public Rulings see the Commentary to this Ruling.

PUBLIC RULING BR PUB 15/04: INTEREST DEDUCTIBILITY – FUNDS BORROWED BY A PARTNERSHIP TO RETURN CAPITAL CONTRIBUTIONS TO A PARTNER

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

Specifically, this Ruling applies the replacement and repayment principle in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle).

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a partnership where:

- the borrowed funds are used to return capital to a partner who previously invested that capital in the partnership;
- interest is incurred on the borrowed funds at an arm's length rate;
- the partnership derives assessable and/or excluded income, or carries on a business for the purpose of deriving such income;

- the partnership derives the income or carries on the business both at the time the funds are borrowed and when interest is incurred; and
- the interest is not deductible to the partner under s DB 7 (Interest: most companies need no nexus with income).

The Arrangement does not include arrangements where, or to the extent that, the partnership uses the borrowed funds to make a payment to the partner:

- of current year income;
- relating to unrealised asset revaluations; or
- relating to internally generated goodwill.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG (Avoidance) applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The partner can deduct their share of interest incurred on the borrowed funds to the extent that the borrowed funds replace the partner's capital contributions and those capital contributions were:
 - directly used in carrying on the partnership's business for the purpose of deriving income; or
 - directly used in deriving the partnership's income; or
 - used to repay other funds borrowed by the partnership and interest incurred on those funds had been deductible.

This Ruling is subject to subpart FE (Interest apportionment on thin capitalisation). The purpose of subpart FE is to ensure that worldwide interest expense is apportioned appropriately to a New Zealand taxpayer.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley
Manager, OCTC

PUBLIC RULING BR PUB 15/05: INTEREST DEDUCTIBILITY – FUNDS BORROWED BY A PARTNERSHIP TO RETURN PAST YEARS' PROFITS TO A PARTNER

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

Specifically, this Ruling applies the replacement and repayment principle in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle).

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a partnership where:

- the borrowed funds are used to pay past years' profits to a partner;
- interest is incurred on the borrowed funds at an arm's length rate;
- the partnership derives assessable and/or excluded income, or carries on a business for the purpose of deriving such income;
- the partnership derives the income or carries on the business both at the time the funds are borrowed and when interest is incurred; and
- the interest is not deductible to the partner under s DB 7 (Interest: most companies need no nexus with income).

The Arrangement does not include arrangements where, or to the extent that, the partnership uses the borrowed funds to make a payment to the partner:

- of current year income;
- relating to unrealised asset revaluations; or
- relating to internally generated goodwill.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG (Avoidance) applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The partner can deduct their share of interest incurred on the borrowed funds to the extent that the borrowed funds are used to pay past years' profits to the partner and the past years' profits were:
 - directly used in carrying on the partnership's business for the purpose of deriving income; or
 - directly used in deriving the partnership's income; or
 - used to repay other funds borrowed by the partnership and interest incurred on those funds had been deductible.

This Ruling is subject to subpart FE (Interest apportionment on thin capitalisation). The purpose of subpart FE is to ensure that worldwide interest expense is apportioned appropriately to a New Zealand taxpayer.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley
Manager, OCTC

PUBLIC RULING BR PUB 15/06: INTEREST DEDUCTIBILITY – FUNDS BORROWED BY A COMPANY TO REPURCHASE SHARES

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

Specifically, this Ruling applies the replacement and repayment principle in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle).

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a company where:

- the borrowed funds are used to repurchase shares from a shareholder of the company as authorised by the Companies Act 1993;
- interest is incurred on the borrowed funds at an arm's length rate;

- the company derives assessable and/or excluded income, or carries on a business for the purpose of deriving such income;
- the company derives the income or carries on the business both at the time the funds are borrowed and when interest is incurred; and
- the interest is not deductible to the company under s DB 7 (Interest: most companies need no nexus with income).

The Arrangement does not include arrangements where, or to the extent that, the company uses the borrowed funds to make a payment to the shareholder:

- of current year income;
- relating to unrealised asset revaluations; or
- relating to internally generated goodwill.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG (Avoidance) applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The company can deduct interest incurred on the borrowed funds to the extent that the repurchased shares were funded by the shareholder's capital contributions or past years' profits, and those capital contributions or past years' profits were:
 - directly used in carrying on the company's business for the purpose of deriving income; or
 - directly used in deriving the company's income; or
 - used to repay other funds borrowed by the company, and interest incurred on those funds had been deductible.

This Ruling is subject to subpart FE (Interest apportionment on thin capitalisation). The purpose of subpart FE is to ensure that worldwide interest expense is apportioned appropriately to a New Zealand taxpayer.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley
Manager, OCTC

PUBLIC RULING BR PUB 15/07: INTEREST DEDUCTIBILITY – FUNDS BORROWED BY A COMPANY TO PAY DIVIDENDS

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

Specifically, this Ruling applies the replacement and repayment principle in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle).

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a company where:

- the borrowed funds are used to pay dividends to a shareholder of the company;
- interest is incurred on the borrowed funds at an arm's length rate;
- the company derives assessable and/or excluded income, or carries on a business for the purpose of deriving such income;
- the company derives the income or carries on the business both at the time the funds are borrowed and when interest is incurred; and
- the interest is not deductible to the company under s DB 7 (Interest: most companies need no nexus with income).

The Arrangement does not include arrangements where, or to the extent that, the company uses the borrowed funds to make a payment to the shareholder:

- of current year income;
- relating to unrealised asset revaluations; or
- relating to internally generated goodwill.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG (Avoidance) applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The company can deduct interest incurred on the borrowed funds to the extent that the dividends were funded by the shareholder's capital contributions or past years' profits, and those capital contributions or past years' profits were:

- directly used in carrying on the company's business for the purpose of deriving income; or
- directly used in deriving the company's income; or
- used to repay other funds borrowed by the company, and interest incurred on those funds had been deductible.

This Ruling is subject to subpart FE (Interest apportionment on thin capitalisation). The purpose of subpart FE is to ensure that worldwide interest expense is apportioned appropriately to a New Zealand taxpayer.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley
Manager, OCTC

PUBLIC RULING BR PUB 15/08: INTEREST DEDUCTIBILITY – FUNDS BORROWED TO REPAY DEBT

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

Specifically, this Ruling applies the replacement and repayment principle in *FC of T v Roberts*; *FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle).

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a taxpayer or partnership where:

- the borrowed funds are used to replace and repay existing borrowed funds to the person who invested or lent the existing funds to the taxpayer or partnership;
- interest is incurred on the borrowed funds at an arm's length rate;
- the taxpayer or partnership derives assessable and/or excluded income, or carries on a business for the purpose of deriving such income;
- the taxpayer or partnership derives the income or carries on the business both at the time the funds are borrowed and when interest is incurred; and

- the interest is not deductible under s DB 7 (Interest: most companies need no nexus with income).

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG (Avoidance) applies to void the arrangement.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Interest incurred on the borrowed funds will be deductible to the extent that the existing funds that are replaced and repaid had been used:
 - directly in deriving a taxpayer's or partnership's income or in carrying on their business for the purpose of deriving income;
 - by a company and the interest was deductible under s DB 7;
 - by a company to purchase shares and the interest was deductible under s DB 8;
 - for one of the Arrangements in BR Pub 15/04–BR Pub 15/07 and met the requirements for interest deductibility in those Rulings;
 - to retain income-earning assets and satisfied the elements in *Public Trustee v CIR* [1938] NZLR 436 as set out in the Commissioner's Interpretation Statement IS0082: "Interest deductibility – *Public Trustee v CIR*", *Tax Information Bulletin* Vol 18, No 6 (July 2006): 9; or
 - to repay other borrowed funds (either directly or through a series of borrowings used to repay borrowings) where interest had been deductible.

This Ruling is subject to subpart FE (Interest apportionment on thin capitalisation). The purpose of subpart FE is to ensure that worldwide interest expense is apportioned appropriately to a New Zealand taxpayer.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley
Manager, OCTC

PUBLIC RULING BR PUB 15/09: INTEREST DEDUCTIBILITY – FUNDS BORROWED TO MAKE A PAYMENT TO A GROUP COMPANY UNDER SECTION IC 5

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

Taxation Law

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

This Ruling applies in respect of s DB 6.

The Arrangement to which this Ruling applies

The Arrangement is the borrowing of funds by a company to make a payment under s IC 5 (Company B using Company A's tax loss) to another company that has a net loss. Interest is incurred on the borrowed funds and the company is unable to claim a deduction under s DB 7 (Interest: most companies need no nexus with income).

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Interest is not deductible in the circumstances described in the Arrangement.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 May 2015.

This Ruling is signed by me on 30 April 2015.

Grant Haley

Manager, OCTC

COMMENTARY ON PUBLIC RULINGS BR PUB 15/04–15/09

This commentary is not a legally binding statement. It is intended to help readers understand and apply the conclusions in Public Rulings BR Pub 15/04–15/09 (“the Rulings”).

The Rulings and commentary express the Commissioner's view of the principle set out in the Australian Full Federal Court decision *FC of T v Roberts; FC of T v Smith* 92 ATC 4,380 (the *Roberts and Smith* principle). BR Pub 15/04–15/08 specifically concern deductibility under the *Roberts and Smith* principle and do not purport to be the Commissioner's view on all aspects of interest deductibility. However, BR Pub 15/09 is of broader application and considers interest deductibility under s DB 6 more generally.

BR Pub 15/04 to 15/08 apply to Arrangements involving the replacement and repayment of existing funding. These Rulings apply to five specific situations where the Commissioner is satisfied that interest incurred on borrowings will be deductible under the *Roberts and Smith* principle. There may be other fact situations not covered by these Rulings where interest may potentially be deductible (either under the *Roberts and Smith* principle or s DB 6 more generally). However, such considerations are outside the scope of these binding Rulings.

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

Summary

1. The purpose of the Rulings is to clarify the test for interest deductibility under s DB 6 in specific fact situations where funds are borrowed to replace and repay existing funding. Other than BR Pub 15/09 (subvention payments), the Rulings apply the principle established in *Roberts and Smith* and do not focus on interest deductibility generally.
2. Expenditure incurred by a person is generally deductible where a sufficient nexus exists with deriving income or carrying on a business for the purpose of deriving income. In the interest deductibility context, the Commissioner considers this nexus is established where the borrowed funds are directly used to derive income or are used in carrying on a business for the purpose of deriving income.
3. The *Roberts and Smith* principle provides that a sufficient nexus will also exist where:
 - a partnership or taxpayer incurs interest on borrowed funds;
 - the borrowed funds are used to replace existing funding and to repay that funding to the person who invested or lent the funds; and
 - the existing funding had been used by the partnership or taxpayer to derive income or in carrying on a business for the purpose of deriving income.
4. The nexus is established through the new funding replacing existing funding. The existing funding must have had a sufficient connection with income, or interest must have otherwise been deductible under other provisions (such as ss DB 7 or DB 8).
5. Capital contributions, past years' profits and debt are all forms of existing funding that the Commissioner is satisfied are capable of being replaced. This is not to say that these are the only situations where

interest may be deductible, or that interest would not otherwise be deductible under general principles. The Rulings apply the Commissioner's view of how the *Roberts and Smith* principle applies to the specific Arrangements covered by each Ruling.

Background

6. The Rulings are reissues of BR Pub 10/14–10/19, which expire on 23 May 2015. BR Pub 10/14–BR Pub 10/19 were published in *Tax Information Bulletin* Vol 22, No 11 (December 2010) and applied for the period beginning on 23 May 2010 and ending on 23 May 2015.

Scope of the Rulings and commentary

7. The Rulings and commentary are intended to have the same scope and effect as the previous Rulings and commentary in BR Pub 10/14–10/19. BR Pub 15/04–15/08 apply to a partnership, company or other taxpayer, and consider the deductibility of interest in specific fact situations under s DB 6 and the *Roberts and Smith* principle. BR Pub 15/09 states that interest on borrowed funds used to make a subvention payment to a group company (under s IC 5) is not deductible under s DB 6.
8. The Rulings do not apply to look-through companies. A look-through company is generally not a “company” under s YA 1 for tax purposes so BR Pub 15/06, 15/07 and 15/09 will not apply. Additionally, the Rulings relating to partnerships (BR Pub 15/04 and 15/05) will not apply. BR Pub 15/08 could potentially apply to the look-through owners, each of whom may be a “taxpayer” (given that look-through companies are transparent under s HB 1). Look-through companies have not been expressly included in the Rulings because, at the time of publishing the Rulings, the tax rules for closely-held companies and look-through companies were under review. However, the Commissioner has issued specific public items on interest deductibility and look-through companies. These are:

- QB 11/03: “Income Tax – look-through companies and interest deductibility” *Tax Information Bulletin* Vol 23, No 10 (December 2011): 16
- QB 12/08: “Income Tax – look-through companies: interest deductibility on funds borrowed to repay shareholder current accounts” *Tax Information Bulletin* Vol 24, No 6 (July 2012): 70
- QB 12/09: “Income Tax – look-through companies: interest deductibility where funds are borrowed to make a payment to shareholders to reflect an asset revaluation” *Tax Information Bulletin* Vol 24, No 6 (July 2012): 72.

9. The Rulings do not apply to arrangements where interest is deductible to a company under s DB 7. This is because s DB 7 provides an automatic deduction for interest incurred by most companies. A company does not need to apply these Rulings if s DB 7 applies. However, some companies cannot apply s DB 7 and so the Rulings are still relevant for those companies.
10. For the avoidance of doubt, the Rulings do not apply to arrangements that are subject to subpart BG. Subpart BG applies to a tax avoidance arrangement, which is void as against the Commissioner for income tax purposes.
11. The deductibility of interest is subject to the thin capitalisation rules in subpart FE. Therefore, the application of the Rulings is also subject to the application of those rules. The application of the thin capitalisation rules is outside the scope of the Rulings and commentary.
12. The Rulings are concerned with the deductibility of interest under the *Roberts and Smith* principle. Understanding the application of the *Roberts and Smith* principle does not require revisiting the reason for the deductibility of interest on the existing funding. Therefore, this commentary does not consider the reasons for the deductibility of the interest on the existing funding in any detail.

Application of the Legislation

13. The purpose of the following analysis is to provide guidance for understanding and applying the conclusions reached in the Rulings.
14. The analysis does not consider general interest deductibility principles in detail. It is intended to provide guidance for certain specific situations (set out in the Arrangements described in BR Pub 15/04–15/08) which the Commissioner is satisfied are covered by the *Roberts and Smith* principle.
15. The analysis will first briefly set out the general statutory provisions and case law on interest deductibility in New Zealand. The analysis will then consider the application of *Roberts and Smith* in New Zealand and explain how the *Roberts and Smith* principle applies to the specific Arrangements in the Rulings.

Interest deductibility – relevant provisions

Section DA 1

16. A person is allowed a deduction for expenditure incurred if the expenditure has a sufficient nexus with income. Section DA 1(1) allows a deduction to the extent that expenditure was incurred in deriving assessable and/or excluded income or in the course

of carrying on a business for the purpose of deriving such income. Section DA 1(1) is known as the “general permission”.

17. For ease of reference, this commentary refers to the nexus requirement in s DA 1(1) as a sufficient connection with “deriving income” or “carrying on a business”.
18. The general permission is subject to the general limitations in s DA 2. These include limitations for expenditure of a capital or private nature.

Section DB 6

19. The Rulings specifically concern interest deductibility under s DB 6, in certain situations.
20. Section DB 6(1) provides that a person is allowed a deduction for interest incurred. Section DB 6(4) provides that the general permission in s DA 1(1) must be satisfied. However, the capital limitation in s DA 2(1) is overridden.
21. Therefore, a deduction is available where a person incurs interest (whether or not it is of a capital nature) and:
 - the interest was incurred in deriving income or in carrying on a business;
 - the general limitations in s DA 2(2)–(6) do not apply; and
 - the deduction is not denied under s DB 1 (interest on unpaid taxes).

Section DB 7

22. Under s DB 7 certain companies are allowed a deduction for interest incurred.
23. Unlike s DB 6, the company does not need to satisfy the nexus requirement in s DA 1(1). Therefore, most companies will rely on s DB 7 to obtain deductions for interest. Section DB 6 and the *Roberts and Smith* principle will not be relevant for such companies.
24. However, certain companies cannot use s DB 7. Section DB 7 does not apply to:
 - Qualifying companies.
 - Companies that derive exempt income or that are part of a wholly-owned group where a company in the group derives exempt income. This does not include exempt income that is dividends, a disposal of a company's own shares or that relates to stake money and a breeding business.
 - Non-resident companies, unless interest is incurred in the course of carrying on a business through a fixed establishment in New Zealand.
 - Interest on unpaid tax under s DB 1.

- Expenditure related to certain assets under subpart DG (ie, mixed-use assets).

25. Although s DB 7 does not refer to look-through companies, a look-through company is not included in the definition of a “company” in s YA 1 for tax purposes.
26. The effect of s DB 7 is discussed in more detail in a discussion on the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 in *Tax Information Bulletin* Vol 13, No 11 (November 2001): 34.

Interest deductibility – general principles

27. The general principles for interest deductibility in New Zealand are established in *Pacific Rendezvous Ltd v CIR* (1986) 8 NZTC 5,146 (CA), *Eggers v CIR* (1988) 10 NZTC 5,153 (CA) and *CIR v Brierley* (1990) 12 NZTC 7,184 (CA). The deductibility of interest requires a sufficient connection between the borrowed funds and deriving income or carrying on a business. In most cases, the test is satisfied when borrowed funds are directly used to derive income, in that the funds are used to acquire income-earning assets.
28. In *Roberts and Smith* and *Public Trustee v CIR* [1938] NZLR 436 (CA), the courts held that interest may be deductible in limited cases where borrowed funds were not directly used in deriving income.
29. *Roberts and Smith* and *Public Trustee* concern situations where borrowed funds were used “in relation to” income-earning assets, but were not “directly used” in deriving income. *Public Trustee* is discussed in IS0082: “Interest Deductibility – *Public Trustee v CIR*” *Tax Information Bulletin* Vol 18, No 6 (July 2006): 9. The *Roberts and Smith* principle is relevant for determining whether interest is deductible when borrowed funds are used to replace and repay existing funding.

The *Roberts and Smith* principle

30. *Roberts and Smith* concerned interest incurred by a partnership. The partnership borrowed funds so it could repay capital contributions to existing partners. This was because new partners were joining the partnership, but the cost of contributing an equal amount of capital was too high. The partners decided to decrease the amount of the existing partners’ capital. They did this by borrowing funds and using the funds to repay the capital contributions to the partners. The Australian Full Federal Court held that the interest incurred on this borrowing was deductible.
31. The case is relevant in New Zealand given the similarity in the wording of the general deductibility provisions. The Australian provision that applied at the time

was s 51(1) of the Income Tax Assessment Act 1936. That section provided that losses or outgoings were deductible to the extent that they were incurred in gaining or producing assessable income, or were necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

32. Hill J considered that interest was deductible irrespective of how the partner used the funds that were repaid to them. This is because the new funding takes on the character of the existing funding that is replaced. The existing funding had been employed in the partnership's business for the purpose of deriving income. Hill J stated at 4,388–4,389:

... let it be assumed that there are undrawn partnership distributions available at any time to be called upon by the partners. The partnership borrows from a bank at interest to fund the repayment to one of the partners who has called up the amount owing to him. That partner uses the moneys so received to purchase a house. A tracing approach, if carried beyond the payment to the partner, encourages the argument raised by the Commissioner in the present case that the funds were used for the private purpose of the partner who received them. But that fact will not preclude the deductibility of the outgoing. **The funds to be withdrawn in such a case were employed in the partnership business; the borrowing replaces those funds and the interest incurred on the borrowing will meet the statutory description of interest incurred in the gaining or production by the partnership of assessable income.**

In principle, such a case is no different from the borrowing from one bank to repay working capital originally borrowed from another; **the character of the refinancing takes on the same character as the original borrowing and gives to the interest incurred the character of a working expense.** Both these cases would equally satisfy the second limb of s. 51(1). In no sense could the interest outgoing in either case be characterised as private or domestic. **Similarly, where moneys are originally advanced by a partner to provide working capital for the partnership, interest on a borrowing made to repay these advances will be deductible, irrespective of the use which the partner repaid makes of the funds.**

[Emphasis added]

33. Hill J considered that the deduction was limited to the extent that the borrowed funds replaced the amount of capital actually contributed into the partnership by the partners. Hill J explained this limitation at 4,390:

Let it be assumed that the original partnership capital in the Lord Lindley sense [i.e. contributed capital] was \$10 and that the balance in the account designated as "the capital account" of the partnership was \$125,000, which included goodwill. That would mean that the

equity of each partner in the partnership, assuming five partners, was \$25,000. But it could not be said that each partner had invested funds totalling \$25,000 as capital in the partnership. A cheque for \$25,000 drawn on the partnership bank account would not operate to repay the partner any funds invested. The partnership capital would remain as \$10, and all that would happen is that there would be a borrowing which was used to pay the partner \$25,000. That borrowing would reduce the partner's equity in the partnership, but it could not represent a repayment of capital invested. The partnership assets would remain constant. The goodwill would still be worth \$125,000; it would not have been distributed to the partners, nor could it be.

On those facts, there could be no question of there being a refund of a pre-existing capital contribution. Rather, looking at the facts objectively, the only purpose of the borrowing would be the provision of funds to the partners to which they were not entitled during the currency of the partnership (save of course by agreement among themselves). **The provision of funds to the partners in circumstances where that provision is not a repayment of funds invested in the business, lacks the essential connection with the income producing activities of the partnership or, in other words, the partnership business. ...**

... If at least \$125,000 of the amount in that account represents **partnership capital** in the Lord Lindley sense, **undrawn profit distributions, advances by the partners or other funds which have actually been invested in the partnership** and which the partners were entitled to withdraw in June 1984, then in my view the taxpayer is entitled to succeed.

[Emphasis added]

34. Hill J considered that interest was only deductible in circumstances where the borrowed funds were replacing funds invested in the partnership business by a partner. The types of existing funding Hill J considered could be replaced include partnership capital, undrawn profit distributions and advances by the partners. The element of replacement of existing funding invested by the partner is critical. Otherwise, the repayment of funds to the partner would lack the essential connection with the partnership's income producing activities or business.
35. Hill J explained that the principle only applies to the repayment of funds to the person who invested the funds in the business (or other income deriving activity). Types of funding that cannot be said to have been invested by a person include internally generated goodwill and asset revaluations. A payment relating to these types of funding is not a replacement and repayment of funds to the person who invested the funds into the business.

36. This replacement and repayment principle is referred to in this commentary and the Rulings as the “*Roberts and Smith* principle”. The *Roberts and Smith* principle applies where:
- borrowed funds are used to replace existing funding;
 - the existing funding is repaid to the person who invested it; and
 - the existing funding had a sufficient connection with deriving income or carrying on the business.
37. Capital contributions, undrawn profits from previous years and advances are all existing funding that is capable of being replaced.
38. There are two aspects of the *Roberts and Smith* principle that require further discussion. The first concerns the use of the borrowed funds. The second concerns the requirement that the funds replace and repay existing funds to the person who invested those funds.

The use of the borrowed funds

39. The deductibility of interest under s DB 6 generally requires that the borrowed funds are directly used in deriving income or in carrying on a business for the purpose of deriving income. Three questions arise regarding the use of the borrowed funds in the context of the *Roberts and Smith* principle. These are:
- If borrowed funds are paid directly to a partner, how can this be said to be used in carrying on the partnership’s business for the purpose of deriving income?
 - If a partner uses the repaid funds for a private use, how can interest incurred on those funds be deductible to the partner?
 - How can one particular debt, with its own parties, conditions and direct uses, inherit the deductibility status of a different debt?

If borrowed funds are paid directly to a partner, how can this be said to be used in carrying on the partnership’s business for the purpose of deriving income?

40. This question concerns situations where the borrowed funds are paid directly to a partner, such as in repayment of a capital contribution.
41. The Commissioner considers that there is a replacement of the existing funding in the partnership’s accounts or financial statements. That is, equity is reduced (through reducing the capital contributions) and debt is increased (through the new borrowings replacing those contributions). The new borrowings can be said to replace the capital contributions that were invested into the partnership

by the partner, and the capital contributions had been used in the partnership’s business.

42. Therefore, the Commissioner considers that, even though borrowed funds may be paid directly to a partner to repay the partner’s capital contributions, the borrowed funds replace those contributions in the partnership’s accounts and can be said to be used in carrying on the partnership’s business for the purpose of deriving income.

If a partner uses the repaid funds for a private use, how can interest incurred on those funds be deductible to the partner?

43. This question relates to the nature of partnerships. A partnership is transparent for tax purposes under s HG 2. This means that the partners deduct their share of the partnership’s expenditure.
44. If a partner’s capital contributions are repaid through borrowed funds and the partner uses the repaid funds for a private or domestic use, it could be argued that the borrowed funds can be traced to a private use. Therefore, it could be argued that s DA 2(2) could limit the deductibility of private or domestic expenditure in such a case.
45. However, for the purpose of a partner’s obligations in their capacity as a partner in a partnership, s HG 2 provides that the partner is treated as carrying on the partnership’s activity. The partner is treated as having the partnership’s status, intention and purpose. So, it is the use of the borrowings by the partnership that is relevant (and not the partner’s secondary use of the funds repaid to them). Further discussion on the nature of partnerships and the ownership of partnership property is set out at [70] to [79] below.
46. The Commissioner considers that, under the *Roberts and Smith* principle, the relevant use of the borrowed funds is to return capital to the partners. Because that capital had been used in carrying on the partnership’s business, its replacement is also considered to be used in carrying on the business. The Commissioner considers that the partners’ use of the funds paid to them is not relevant for the purposes of determining deductibility under the *Roberts and Smith* principle.

How can one particular debt, with its own parties, conditions and direct uses, inherit the deductibility status of a different debt?

47. This question relates to a basic principle of deductibility, which is that the deductibility of an expense depends on the circumstances in which that expense is incurred. In *Roberts and Smith*, Hill J simply states that interest on a debt that replaces

another debt is deductible. However, that statement is not an explanation, and it is not entirely clear that a debt replacing another debt necessarily inherits its deductibility status.

48. A contrary approach was taken in Canada, in *Interior Breweries Ltd v Minister of National Revenue* [1955] CTC 143; 55 DTC 1090. Cameron J of the Exchequer Court held that interest was not deductible where borrowed funds were used to repay a bank loan. Cameron J considered that the borrowed money was not used to earn income, but was “used entirely to pay off the bank loan ...” (at 148). However, legislation was introduced in Canada to reverse the effect of that decision, and it appears that the decision has not been applied in any later cases.
49. The Commissioner considers it likely that *Interior Breweries* would not be followed by the courts in New Zealand or Australia. Nevertheless, the New Zealand and Australian courts have generally been cautious about allowing deductions relating to indirect uses of borrowed funds (particularly in the lower courts in situations where there has been private use of funds). However, the courts have allowed deductions for certain indirect uses of funds in particular circumstances in cases such as *Roberts and Smith* and *Public Trustee*. *Public Trustee* concerned the deductibility of interest on funds that were borrowed to pay death duties and to avoid a sale of income-earning assets. Nexus with income existed in the particular circumstances through the use of the funds to pay the debts and, therefore, to retain income-earning assets.
50. Cases such as *Public Trustee* and *Roberts and Smith* are examples of the limited situations and particular circumstances where courts have accepted that interest may be deductible when borrowed funds are not directly used to derive income. In the *Roberts and Smith* context, this is when borrowed funds replace and repay existing funding to the person who invested those funds, and the existing funding had the sufficient nexus with income.

The borrowed funds must replace and repay existing funds to the person who invested those funds

51. A further aspect of the *Roberts and Smith* principle is that the borrowed funds must replace existing funding and repay the person who invested those existing funds in the business.
52. Hill J said at 4,390 of *Roberts and Smith*:

The provision of funds to the partners in circumstances where that provision is not a repayment of funds invested in the business, lacks the essential connection

with the income producing activities of the partnership or, in other words, the partnership business.

53. Where borrowed funds are used to replace and repay existing funds to the person who invested or lent those funds to the business (or other income-producing activity), the borrowed funds will take on the deductibility status of the existing funds. So, if the existing funds had a sufficient connection with the carrying on of the business or the derivation of income, the borrowed funds that take the place of the existing funds will also take on that connection. The *Roberts and Smith* principle will not apply without this aspect of replacement and repayment to the person who invested or lent funds to the business (or other income-producing activity).
54. This is not to say that interest on other borrowed funds is not otherwise deductible, but such considerations are outside the scope of these Rulings and this commentary. For example, a business might borrow to acquire new income-earning assets. While interest on such borrowings may be deductible under s DB 6, this is under the operation of general interest deductibility principles and not through the application of the *Roberts and Smith* principle. Similarly, a business might borrow funds to make a nil interest loan, to invest in a company that was barred from making distributions or to pay criminal fines. In such cases, no underlying connection with income exists and so interest would not be deductible under s DB 6 in any circumstance. The *Roberts and Smith* principle would not apply to make such interest deductible.

Sole traders

55. Individuals, who do not operate their business (or otherwise derive income) through a company, partnership or other structure, do not have a separate entity in which to invest their funds. In such a case, no change in the ownership of those funds occurs. The Commissioner considers that the *Roberts and Smith* principle does not apply in these circumstances.
56. Sole traders or individuals may consider that borrowed funds have the effect of returning capital or past years’ profits to them. However, it is artificial for a person to describe a transaction with themselves as a “replacement and repayment” of an investment.
57. However, a sole trader or individual can deduct interest on borrowed funds where the borrowed funds replace and repay a debt owed to a third party lender and the debt had been used directly in deriving income or in carrying on a business. The Commissioner considers that, as the funds in such a

situation are repaid to a separate person, the *Roberts and Smith* principle can apply.

Relevant New Zealand cases

58. To date, *Roberts and Smith* has not been applied by a New Zealand court. There are two Taxation Review Authority (TRA) cases on similar issues, but these were decided prior to *Roberts and Smith*.
59. The approach of the TRA in *Case P56* (1992) 14 NZTC 4,386 is similar to the Commissioner's interpretation of *Roberts and Smith*. In *Case P56*, partners in a partnership borrowed funds to withdraw more than they had invested in the partnership. Judge Willy concluded that the interest was not deductible. Judge Willy said at 4,396 that if the partners had replaced capital investments they would have been entitled to interest deductions.
60. A different conclusion was reached by the TRA in *Case M127* (1990) 12 NZTC 2,817. In *Case M127*, partners in a partnership required money for personal reasons. The partners had invested \$76,000 of equity into the business. The partnership paid \$70,000 to the partners, putting the partnership account into overdraft. The partnership borrowed to repay the overdraft. The effect on the partnership's balance sheet was that the capital contributed by the partners was replaced by the borrowed funds. The partners argued that the borrowed funds were used in producing income. However, the TRA concluded that the use of the funds was for the partners' private use, and interest was not deductible. It appears that the partners did not argue that the borrowed funds replaced and repaid their equity contributions. It also appears that such a principle was not considered by the TRA.
61. As previously stated, the general test for interest deductibility, as established in cases such as *Pacific Rendezvous*, *Eggers* and *Brierley*, requires borrowed funds to be directly used or "traced" to income. The *Roberts and Smith* principle effectively applies an "indirect" tracing test. That is, the borrowed funds must replace existing funds that were invested in the business, and those existing funds must have had the sufficient connection with income. However, this principle does not require that the borrowed funds are also traced to the use of the person who was repaid. In *Roberts and Smith*, Hill J said at 4,388:

A tracing approach, if carried beyond the payment to the partner, encourages the argument raised by the Commissioner in the present case that the funds were used for the private purpose of the partner who received them. But that fact will not preclude

the deductibility of the outgoing. The funds to be withdrawn in such a case were employed in the partnership business; the borrowing replaces those funds and the interest incurred on the borrowing will meet the statutory description of interest incurred in the gaining or production by the partnership of assessable income.

62. A strict tracing approach was applied by the TRA in *Case M127*. This approach indicated that the loan was used to repay a business overdraft, and the overdraft was traced to private use by the partners. However, under the approach taken in *Roberts and Smith*, the loan could be seen as replacing the overdraft and the overdraft replaced the partners' equity invested in the business. The partners' equity was directly used to fund the partnership's business. Therefore, a sufficient connection with income would exist under this approach. In the absence of such a principle at the time *Case M127* was decided, Judge Bathgate held that the borrowed funds were used for private purposes.
63. The Commissioner considers that a decision of the Full Federal Court of Australia, based on legislation that had similar wording to the New Zealand legislation at the time, would be treated as more persuasive by New Zealand courts. The Commissioner considers that a New Zealand court is likely to follow *Roberts and Smith* rather than *Case M127*.

Conclusion – the application of *Roberts and Smith* in New Zealand

64. The Commissioner considers that the New Zealand courts would apply the *Roberts and Smith* principle in situations where:
 - borrowed funds are used to replace existing funding;
 - the existing funding is repaid to the person who invested it; and
 - the existing funding had a sufficient connection with deriving income or carrying on the business.
65. The *Roberts and Smith* principle provides that, in such situations, interest incurred on the new funding will take on the deductibility status of the existing funding.
66. This commentary will now discuss how this principle applies to the specific Arrangements in BR Pub 15/04–15/08. The commentary will also go on to discuss certain situations including the Arrangement in BR Pub 15/09 where the Commissioner considers that the principle will not apply.

Arrangements to which the *Roberts and Smith* principle applies

67. The following analysis explains the Commissioner's position on interest deductibility under the *Roberts*

and *Smith* principle in the context of the specific Arrangements to which the Rulings apply.

Returns of capital to partners: BR Pub 15/04

- 68. BR Pub 15/04 applies where borrowed funds are used by a partnership to return capital to a partner who previously invested that capital into the partnership.
- 69. *Roberts and Smith* specifically concerned this situation. The *Roberts and Smith* principle applies where borrowed funds are used by a partnership to repay capital contributions to partners. Interest is deductible to the extent that the capital that was repaid to partners had been used by the partnership in carrying on its business.
- 70. An issue that arises concerns ownership of partnership property. For example, it could be argued that a partnership is not able to repay a partner's contributions to the partner. This is on the basis that a partnership is not a legal entity, and the ownership of partnership property already vests in the partners.

Ownership of partnership property

- 71. A key concept of partnership law is that partners do not have individual rights to partnership property. This point has been made in several cases, including *Hadlee & Sydney Bridge Nominees Ltd v CIR* (1993) 15 NZTC 10,106 (PC), *CIR v Boanas* (2008) 23 NZTC 22,046 (HC) and *Crowe v C of T* (1958) 100 CLR 532 (HCA). It was also confirmed by Webb and Molloy in *Principles of the Law of Partnership* (Butterworths, Wellington, 6th edition, 1996).
- 72. In *Hadlee* (PC) Lord Jauncey of Tullichettle stated at 10,110:

... First of all as a matter of general law, to quote the words of Richardson J [in *Hadlee and Sydney Bridge Nominees Ltd v CIR* (1991) 13 NZTC 8,116 (CA)] he **“does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership.”** (*Lindley on Partnership* 15th Edition, page 516)”. He can enforce this interest against his co-partners to the extent of seeing that the partnership assets are used for the benefit of the partnership but he cannot assign it to a non-partner. This beneficial interest, expressed in terms of its realisability, is in the nature of a future interest taking effect in possession on (and not before) the determination of the partnership (*Lindley and Banks on Partnership*, 16th Edition, p 457).

[Emphasis added]

- 73. In the Court of Appeal (*Hadlee and Sydney Bridge Nominees Ltd v CIR* (1991) 13 NZTC 8,116 (CA)), Richardson J had referred to a share in a partnership as being a fractional interest in the future profits of the

partnership business (at 8,126). In *Boanas*, Dobson J noted at [65] that Richardson J's judgment in *Hadlee* was consistent with s 23(1) of the Partnership Act 1908.

- 74. Section 23(1) of the Partnership Act 1908 states:

All property and rights and interests in property ... must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.
- 75. Section HG 2(1) of the Income Tax Act 2007 provides that partnerships are transparent for income tax purposes (unless the context requires otherwise). This means that, for the purposes of calculating their obligations and liabilities under the Act, the partners are generally treated as:
 - carrying on activities and having the status, intention and purpose of the partnership; and
 - holding property that a partnership holds, being party to an arrangement to which the partnership is party, and doing or being entitled to a thing that the partnership does or is entitled to, in proportion to their partnership share.
- 76. Section HG 2 does not alter the principle that partnership income is derived, and partnership property is owned, jointly by the partners. Section HG 2 applies “[f]or the purposes of a partner's liabilities and obligations under this Act in their capacity of partner of a partnership”. This makes it clear that s HG 2(1) applies to calculating a partner's tax obligations and liabilities. Section HG 2 does not affect the partners' individual rights to partnership property under general law.
- 77. In summary, partners own an undivided interest in partnership property and do not have individual title to any particular items of partnership property. Therefore, a partnership can validly transfer property to a partner because the nature of the legal ownership would change from joint ownership to ownership by a single person.
- 78. *Roberts and Smith* specifically applied to partners in a partnership. The above analysis shows that the application of the *Roberts and Smith* principle in a partnership situation would be consistent with the treatment of partnership property in New Zealand.
- 79. It is noted that a return of capital, whether by a partnership or a company, does not itself have a sufficient connection with deriving income or carrying on a business simply because it is an ordinary part of running a business. A return of capital is generally not part of the income-earning process of the business, but relates to the structure of the business. However,

a sufficient connection with deriving income or carrying on a business exists in this Arrangement. This is because borrowing to return capital to partners has the effect of replacing and repaying an amount that was invested into the business by the partner. The initial amount invested into the business had a connection with carrying on the business or deriving income. In these circumstances, the borrowed funds will continue that connection with deriving income or carrying on a business.

Payments of past years' profits to partners:
BR Pub 15/05

80. BR Pub 15/05 applies where borrowed funds are used to repay past years' partnership profits to partners. Interest is deductible under the *Roberts and Smith* principle to the extent that the borrowed funds are used to repay past years' profits to partners, and those profits had been used directly in the partnership's business (or to repay funds borrowed by the partnership where interest had been deductible).
81. In *Roberts and Smith*, Hill J referred to past years' profits as "undrawn profit distributions". These can be viewed as amounts contributed by partners to the partnership. Partnership profits are allocated to partners equally or in accordance with the divisions in the partnership agreement. If profits are not withdrawn, the accounting treatment might be to carry profits to the credit of the partners' current accounts by book entry, calculated at the end of the accounting period. Although there may not be any active reinvestment by the partners themselves, this process can reasonably be seen as an investment of capital into the business.
82. The Commissioner considers that retaining and using past years' profits in the partnership's business can be seen as a reinvestment by partners in the partnership. Interest is deductible on borrowings used to repay past years' profits to partners, to the extent that the profits were used in the partnership's business.
83. However, BR Pub 15/04 and 15/05 do not apply to the extent that borrowed funds are used to pay current year income to partners. The reasons for this will now be considered.

Why the Ruling does not apply to the payment of current year income to partners

84. The Commissioner's opinion is that the *Roberts and Smith* principle does not extend to borrowings that return current year income to partners. A distinction is made here between current year income and net income or profits that are finally determined. Current

year income has generally not been identified as net income or profits of the partnership, which the partners are entitled to withdraw from the partnership.

85. The issue with current year income is whether the partners can be said to have invested the amount back into the partnership. The Commissioner considers that, generally, current year income is not an amount that can be finally determined as being an amount "invested" into the partnership by the partners, and so is not an amount that is "repaid" to partners. The amount can only have been invested in the partnership if someone other than the partnership has had an entitlement to it at some time. Therefore, the issue is whether partners can be said to have become individually entitled to current year income at a point in time before repayment is made.
86. The legal nature of current year partnership income is relevant to answering this question. As previously discussed in this commentary, a distinction exists between partnership property and property of individual partners. If current year partnership income is determined and a share of the net income or profits is allocated to individual partners at any point during the year, it could in theory be said to have been invested by partners in the partnership business (and, therefore, would be "repayable" to the partners).
87. The Partnership Act 1908 is silent on the treatment of current year income. Section 27 provides for the division of profits as follows:

27 Rules as to interests and duties of partners

The interests of partners in the partnership property, and their rights and duties in relation to the partnership, shall be determined, subject to any agreement (express or implied) between the partners, by the following rules:

- (a) all the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses, whether of capital or otherwise, sustained by the firm:
- ...
- (d) a partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him:

88. Partners are entitled to share in partnership profits (subject to an agreement to the contrary). However, the concept of "profits" is not defined. There is no particular guidance in the Partnership Act 1908 as to when the division and allocation of profits occurs.
89. The amount that forms part of each partner's share of profits from a partnership is ascertained after the partnership accounts have been prepared. In *FC of T v Galland* 86 ATC 4,885, the High Court of Australia

held that, in the absence of an agreement otherwise, partnership accounts would be taken each year as at 30 June. A partner's share of the partnership's profits or net income would be distributed to the partner at that time. *Mason and Wilson JJ* said at 4,887:

... although a partner is not usually entitled to call for a distribution of profits or net income until accounts have been prepared, he has an individual interest in the net income of the partnership, notwithstanding that the precise amount of his interest cannot be determined until the accounts are prepared in respect of the relevant period.

90. The High Court of Australia's view is that partners have an individual interest in the net income or profits of the partnership, but not an immediate entitlement to the net income or profits until accounts have been prepared.

91. *Galland* was cited by Hill J in *Roberts and Smith* as authority for the proposition that, in the absence of agreement, a partner's share of the partnership's income is derived by the partner once annual partnership accounts have been prepared. Hill J said at 4,390:

In the absence of agreement, accounts of the partnership would be required to be taken each year as at 30 June and a partner's share of the partnership income would be derived by him as at that date: *FC of T v Galland* ...

92. Further, the nature of "profits" is that they have to be identified before anyone can become entitled to them. As cited in *Galland*, a definition of "profits" was provided in *Re Spanish Prospecting Co. Ltd* [1911] 1 Ch 92 (CA) by Fletcher Moulton LJ at 98–99:

"Profits" implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at two dates. ...

We start, therefore, with this fundamental definition of profits, viz, if the total assets of the business at the two dates be compared, the increase which they show at the later date as compared with the earlier date (due allowance, of course, being made for any capital being introduced into or taken out of the business in the meanwhile) represents in strictness the profits of the business during the period in question.

93. Profits can be calculated once the total amounts of income and expenses for the relevant fiscal period are known. Although income will come in that may, in due course, form part of the "profits", the finally determined amount cannot be known until the relevant fiscal period has ended and accounts

prepared. In the Commissioner's opinion, it follows that a legal entitlement to partnership profits cannot arise until the amount can be finally determined, and this is at the end of the relevant fiscal period (which is generally annual but may depend on the particular facts).

94. Therefore, the Commissioner considers that, generally, a partner does not have an individual entitlement to current year partnership income until the accounts for the relevant fiscal period have been prepared, an amount of profit has been finally determined, and partners are entitled to their share of the resulting profits. Generally, current year income is owned by all of the partners jointly. Individual partners have an ownership interest in that income (in common with the other partners), but the Commissioner considers that no entitlement to an individual share exists until profits have been calculated and allocated for a fiscal period. This means that current year income is generally not an investment that can be "repaid" to partners.

95. The Commissioner's opinion that current year income is not generally an amount that can be repaid to partners is consistent with Hill J's reasoning at 4,389 to 4,390 in *Roberts and Smith*. Hill J considered that amounts that can be repaid and replaced are funds that have actually been invested in the partnership and that the partners are entitled to withdraw. Hill J listed the types of capital represented in the partnership's accounts. Of these amounts, he considered the types of capital that could be replaced and repaid to an investor. Hill J did not include internally generated goodwill, asset revaluations and profits of the year not yet distributed as amounts able to be replaced and repaid to an investor. Hill J considered that undrawn distributions that have been allocated to partners but not paid (such as past years' profits) can be replaced with borrowings, and the interest relating to such amounts would be deductible.

Summary

96. Past years' profits that remain in the partnership are viewed as an advance from the partners to the partnership, or as new investments of capital. Hill J considered that a partnership's past years' profits could be viewed as amounts invested into the partnership by the partners, and that they could be repaid to the partners. Therefore, interest incurred on funds that are borrowed to repay past years' profits to a partner is deductible under the *Roberts and Smith* principle.

97. It is essential for the application of the *Roberts and Smith* principle that the borrowings replace existing

funding, and are repaid to the person who invested that funding. In the Commissioner's opinion, current year income has not been invested by anyone, so the principle does not generally apply.

98. The Commissioner considers that, for the purposes of the *Roberts and Smith* principle, partners do not generally have rights to current year income as it arises during the year. Partnership profits or net income are generally determined at the end of the relevant fiscal period (presumed to be the financial year for the purposes of the relevant Rulings) and, until this happens, the partners are not entitled to a share of the income arising during that year. Although a partner might take drawings out of the current year income during the year, this is generally only an anticipated share of the profits or net income that is finally established at the end of the financial year. Current year income is not an amount that can be seen as being invested into the partnership by the partners. While there may be scope to argue that current year profits are an investment made by partners into the partnership, the Commissioner considers that the nature of such profits is too uncertain to be able to include them within the scope of a binding ruling.
99. Past years' profits can be distinguished from current year income because the partners have become entitled to their share of those past years' profits. The entitlement occurs at a time specified under the partnership agreement or, in the absence of a partnership agreement, when the partnership accounts are taken and the profits notionally allocated to partners.

Share repurchases: BR Pub 15/06

100. BR Pub 15/06 applies where borrowed funds are used by a company to repurchase shares from its shareholders (as authorised by the Companies Act 1993).
101. Note that interest may be deductible to the company under s DB 7. BR Pub 15/06 is only of relevance to companies to which s DB 7 does not apply.
102. The repurchase of a company's shares involves a payment made by the company to its shareholders of amounts previously contributed by the shareholders. The repurchase of bonus share issues that were funded by past years' profits can also be seen as involving a payment by a company to its shareholders of amounts previously contributed by shareholders. The effect of the company's payment will reduce the shareholder's capital holding in the company. Therefore, this Arrangement is analogous to a return of capital or past years' profits to partners in a partnership (discussed above).
103. In the Commissioner's view, the *Roberts and Smith* principle may apply to share repurchases (including repurchases of bonus issue shares). Interest is deductible on borrowings used to repay share capital or past years' profits to shareholders, to the extent that the capital or profits were used by the company in deriving income or in carrying on its business.
- #### Payments of dividends: BR Pub 15/07
104. BR Pub 15/07 applies where borrowed funds are used by a company to pay dividends to shareholders that relate to past years' profits (ie, retained earnings). As with the previous Arrangement, the interest may be deductible to the company under s DB 7. BR Pub 15/07 is only of relevance to companies in situations where s DB 7 does not apply.
105. There is some conceptual difficulty in bringing a company's retained earnings within the *Roberts and Smith* principle. The difficulty is in equating retained earnings with amounts "invested" into the company by shareholders. This is because, unlike a partnership, a company's profits are not allocated to shareholders at the end of each year. Rather, any retained earnings are added to the company's existing retained earnings. Company directors may or may not decide to distribute some of these retained earnings as a dividend. Therefore, shareholders have no immediate entitlement to retained earnings in the way that partners are entitled to a share in partnership profits.
106. Nevertheless, there are similarities between a partnership's past years' profits and a company's retained earnings, such that comparisons can be drawn (although it is acknowledged that there are differences). For example:
- Both amounts have been finally settled for the year, and the theoretical amount each shareholder or partner is entitled to can be established.
 - In a sense, retained earnings and past years' profits that remain in the business can be seen as an amount that a shareholder or partner has "invested" into the business.
 - Retained earnings and partnership profits are at the disposal of the business until a decision is made to pay them out to the shareholders or partners. Just as partners may not necessarily make an active decision to invest past profits into the partnership, a company's shareholders would not make a decision to invest profits into the company as retained earnings.
107. The Commissioner considers that funds borrowed by a company to pay dividends to shareholders that

relate to retained earnings are somewhat analogous to funds borrowed by a partnership to pay past years' profits to partners. The Commissioner considers that the *Roberts and Smith* principle should apply in such situations.

108. Therefore, the Commissioner considers that interest is deductible on borrowings used by a company to pay dividends to shareholders relating to past years' profits, to the extent that those profits had been used by the company in deriving income or in carrying on its business. If company profits are distributed as bonus issue shares, then, similarly, the amount represented by the shares can be seen as capital that is able to be replaced and repaid.
109. As concluded earlier, the Commissioner considers that the *Roberts and Smith* principle does not generally apply where a partnership uses borrowed funds to pay current year income to partners. Similarly, shareholders in a company do not have an immediate entitlement to the company's current year income, and they cannot be considered to have invested that income into the company. Therefore, the Commissioner considers that the *Roberts and Smith* principle does not apply where borrowed funds are used to pay current year income to a shareholder.

Replacement of debt: BR Pub 15/08

110. The Arrangement considered in BR Pub 15/08 is broader than the previous Arrangements. BR Pub 15/08 applies where borrowed funds are used by a partnership or taxpayer to replace existing debt and to repay the amounts to the person who lent the funds to the taxpayer or partnership.
111. The Commissioner considers that the *Roberts and Smith* principle applies where borrowed funds repay another debt that was directly used in deriving income or in carrying on a business. In *Roberts and Smith*, Hill J considered that there is no difference (for interest deductibility purposes) between repaying one debt with another and borrowing to return capital. Hill J considered that both situations should be similarly treated. Hill J said that where borrowings are used to repay existing debt, and the existing debt had been used in an income-earning business, the refinancing will take on the character of the existing debt.
112. In addition, if new borrowings take on the character of existing debt that is replaced, then logically subsequent refinancing should also inherit that character. Therefore, the Commissioner considers that interest is deductible on borrowings used to repay existing borrowings to the extent that existing borrowings can be traced to a use that gave rise to deductible interest.

113. There are three further issues to consider when borrowed funds are used to replace existing debt. These are:

- whether interest is deductible if the interest on the existing debt was deductible under a provision that did not require nexus with income, such as ss DB 7 and DB 8;
- whether interest is deductible where the lender's right to be repaid is assigned to another person; and
- whether direct tracing is required.

Deductibility where no nexus was required

114. The general principle from *Roberts and Smith* is that interest on borrowings may inherit the deductibility status of interest on funds the borrowings replace and repay. In some situations, the interest incurred on the existing debt may have been deductible under a specific interest deductibility provision, rather than the general permission. Section DB 7 provides for automatic deductions for most companies. Section DB 8 provides for deductions for companies investing in shares in a group company.
115. The Commissioner considers that deductibility status under ss DB 7 and DB 8 should also be inheritable by replacement funding. If it were not, and refinancing meant that interest that had been deductible was no longer deductible (as a matter of law rather than fact), Parliament's intention for ss DB 7 and DB 8 would seem to be defeated.
116. Therefore, the Commissioner considers that the *Roberts and Smith* principle applies when interest on the funding that is replaced had been deductible under ss DB 7 or DB 8.

Deductibility where the lender's right to be repaid is assigned

117. The Commissioner considers that the *Roberts and Smith* principle requires the repaid funds to be returned to the person who invested the funds. However, an exception to this is where the right to receive repayments has been assigned to someone else. The Commissioner considers that interest is still deductible in this situation because there has been a repayment of funds invested. The amounts can be traced back to the original investor through the assignee.

Whether deductibility requires direct tracing

118. In several cases that have considered interest deductibility, the courts held that the funds must be directly used in, or traced to, deriving income: see *Pacific Rendezvous Ltd* and *Brierley*.

119. The Commissioner considers that the *Roberts and Smith* principle is consistent with a tracing approach to interest deductibility. The *Roberts and Smith* principle requires identifying both that the new borrowings replace and repay existing funds, and that the existing funds were used in carrying on a business or in deriving income. The existing funding must have had a sufficient connection with (or be traced to) the derivation of income.
120. In the previous issue of these Rulings, the Commissioner considered the compliance costs that may arise for some taxpayers if tracing is required. It was recognised that, for some taxpayers who have daily changes to their borrowings, the tracing requirement may be difficult to fulfil. Although two potential solutions were canvassed, the Commissioner considered them to be impractical.
121. One approach considered was to allow a deduction in situations where borrowings are taken out and the initial funding repaid at about the same time. However, the Commissioner considers that, in practice, an “about the same time” requirement could not be limited to *Roberts and Smith* situations. This could result in interest on any borrowings qualifying for deductibility. This would be inconsistent with the requirement for a nexus with income under s DB 6.
122. Another approach considered was to accept that all borrowings are a replacement of existing funds, unless used solely for a private or exempt use. However, that would also seem to be too wide as any use of borrowings could potentially satisfy such a test. Further, this approach would also be inconsistent with the *Roberts and Smith* principle, which requires that funds are returned to those who invested them. Without this element of replacement, insufficient nexus with income exists.
123. Therefore, the Commissioner considers that a tracing approach is required for deductibility in the context of the *Roberts and Smith* principle.
124. Nevertheless, the Commissioner considers that problems regarding tracing are unlikely to arise in most cases. This is because taxpayers with few borrowings should usually be able to trace their funding. Taxpayers with more complicated borrowing practices are, in most cases, likely to be companies that can claim interest deductions under s DB 7.

Arrangements to which s DB 6 and/or the *Roberts and Smith* principle do not apply

125. The following paragraphs discuss the types of arrangements where the Commissioner considers that

interest is not deductible under s DB 6 and/or the *Roberts and Smith* principle.

Subvention payments: BR Pub 15/09

126. BR Pub 15/09 applies to an Arrangement where a company borrows funds to make a payment under s IC 5 to another company that has a net loss and is in the same group of companies. This type of payment is commonly referred to as a “subvention payment”. The Ruling provides that interest incurred on those borrowed funds will not be deductible under s DB 6.
127. A subvention payment is a payment between companies in a group to reduce the overall tax burden of the group. It is not a replacement of an amount previously advanced by the recipient company, or an amount that is paid to shareholders in repayment of amounts they invested in the company. Therefore, the Commissioner considers that the use of borrowed funds to pay a subvention payment does not satisfy the *Roberts and Smith* principle. Interest incurred on borrowed funds used to pay a subvention payment is not deductible under that principle.
128. Unlike the other related Rulings, BR Pub 15/09 is not limited to deductibility under the *Roberts and Smith* principle. BR Pub 15/09 states that interest on borrowed funds used to make a subvention payment will not be deductible under s DB 6.
129. This wider application of BR Pub 15/09 is necessary because the Commissioner considers that a subvention payment will not have a sufficient connection with deriving income or carrying on a business under the general permission. This is because:
- The relevant payment is made when a company’s annual profits have been determined. This occurs after the company has already derived its income for the year, and so the payment cannot be an amount of expenditure incurred in deriving its income.
 - Further, the Commissioner considers that such a payment is not made by the company in the course of carrying on its business for the purpose of deriving income. The payment is made to reduce the overall tax burden of the group, when there are both loss and profit-making companies within that group.
130. Therefore, the Commissioner considers that interest incurred on borrowed funds that are used to make a subvention payment under s IC 5 to a group company will not satisfy the general permission and so will not be deductible under s DB 6.
131. The Commissioner notes that this issue is unlikely to arise in practice. Interest incurred by most companies

will be deductible under s DB 7, regardless of the use of the funds. However, BR Pub 15/09 will be relevant in situations where s DB 7 does not apply.

132. The Commissioner acknowledges that the treatment of such borrowings differs between companies that can apply s DB 7 and companies that cannot. However, this is through the operation of the interest deductibility provisions in ss DB 6 and DB 7, and not through the application of the *Roberts and Smith* principle.

Payments relating to internally generated goodwill and asset revaluations

133. The Arrangements described in BR Pub 15/04–15/08 do not include arrangements where, or to the extent that, borrowed funds are used to make a payment that relates to unrealised asset revaluations or internally generated goodwill.
134. In *Roberts and Smith*, Hill J singled out internally generated goodwill as an amount in the partnership capital account that could not be replaced and repaid to partners. This was because it is not an amount that has been invested by the partners into the business. Hill J explained that a payment of goodwill is not a “refund of a pre-existing capital contribution” (at 4,390).
135. Further, Susan Glazebrook and Jan James in *Taxation Implications of Company Law Reform* (1995) 1 NZJTL 132 at 157 explained that goodwill cannot be distributed because, even after any purported distribution, it would still remain in the business.
136. Therefore, the Commissioner considers that internally generated goodwill is not an amount that can be replaced and repaid to partners or shareholders. The Rulings do not apply to such payments.
137. The situation will be different if goodwill is purchased. In that situation, funds (either equity or debt) will be used to purchase the goodwill. These funds can be repaid and replaced with other borrowed funds. Therefore, interest on replacement borrowings would be deductible under the *Roberts and Smith* principle if the existing funding used to purchase that goodwill is repaid to the person who lent or invested those funds. However, if purchased goodwill is revalued internally, the extent of the internal revaluation cannot be said to be an amount invested in the business by a partner or shareholder.
138. Therefore, interest incurred on borrowed funds that are purporting to replace internally generated goodwill will not be deductible under the *Roberts and Smith* principle.

139. For the same reasons, the *Roberts and Smith* principle does not apply to amounts that are attributable to asset revaluations. This is because these amounts do not relate to an amount invested or lent by a person to the business, and they cannot be replaced and repaid to a person who invested those amounts.

Australian Taxation Office’s view on *Roberts and Smith*

140. The Australian Taxation Office issued a ruling on its interpretation of *Roberts and Smith*. See TR 95/25 Income Tax: deductions for interest under subsection 51(1) of the Income Tax Assessment Act 1936 following *FC of T v Roberts; FC of T v Smith*, issued 29 June 1995. The Australian Taxation Office’s view is similar to the Commissioner’s view in these Rulings. Two addenda have been added to TR 95/25, primarily to update the references in the ruling to the Australian Income Tax Assessment Act 1997.
141. A consistent interpretation of *Roberts and Smith* was also applied in TR 2005/12 Income tax: deductibility of interest expenses incurred by trustees on funds borrowed in connection with the payment of distributions to beneficiaries, issued 6 July 2005. TR 2005/12 relates to borrowings used to repay amounts to beneficiaries.

References

Expired Rulings
BR Pub 10/14–10/19 “Interest deductibility – <i>Roberts and Smith</i> – Borrowing to replace and repay amounts invested in an income earning activity or business”, <i>Tax Information Bulletin</i> Vol 22, No 11 (December 2010): 2
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Legislative references
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Partnership Act 1908 – ss 23, 27
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<i>Case M127</i> (1990) 12 NZTC 2,817
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<i>Re Spanish Prospecting Co. Ltd</i> [1911] 1 Ch 92 (CA)
Other references
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QB 11/03: "Income Tax – look-through companies and interest deductibility" <i>Tax Information Bulletin</i> Vol 23, No 10 (December 2011): 16
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Susan Glazebrook and Jan James <i>Taxation Implications of Company Law Reform</i> (1995) 1 NZJTL 132
TR 95/25 Income Tax: deductions for interest under subsection 51(1) of the Income Tax Assessment Act 1936 following <i>FC of T v Roberts</i> ; <i>FC of T v Smith</i> , issued 29 June 1995
TR 2005/12 Income tax: deductibility of interest expenses incurred by trustees on funds borrowed in connection with the payment of distributions to beneficiaries, issued 6 July 2005
Webb and Molloy <i>Principles of the Law of Partnership</i> (Butterworths, Wellington, 6th edition, 1996)

APPENDIX – LEGISLATION

Income Tax Act 2007

1. Section DA 1 contains the "general permission":

DA 1 General permission

Nexus with income

- (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
 - (a) incurred by them in deriving—
 - (i) their assessable income; or
 - (ii) their excluded income; or
 - (iii) a combination of their assessable income and excluded income; or

- (b) incurred by them in the course of carrying on a business for the purpose of deriving—
 - (i) their assessable income; or
 - (ii) their excluded income; or
 - (iii) a combination of their assessable income and excluded income.

General permission

- (2) Subsection (1) is called the **general permission**.

Avoidance arrangements

- (3) Section GB 33 (Arrangements involving depreciation loss) may apply to override the general permission in relation to an amount of depreciation loss.

2. Section DA 2 contains the "general limitations":

DA 2 General limitations

Capital limitation

- (1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.

Private limitation

- (2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.

Exempt income limitation

- (3) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving exempt income. This rule is called the **exempt income limitation**.

Employment limitation

- (4) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving income from employment. This rule is called the **employment limitation**.

Withholding tax limitation

- (5) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving non-resident passive income of the kind referred to in section RF 2(3) (Non-resident passive income). This rule is called the **withholding tax limitation**.

Non-residents' foreign-sourced income limitation

- (6) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving non-residents' foreign-sourced income. This rule is called the **non-residents' foreign-sourced income limitation**.

Relationship of general limitations to general permission

- (7) Each of the general limitations in this section overrides the general permission.

3. Section DA 3 explains the effect of specific rules on general rules:

DA 3 Effect of specific rules on general rules

Supplements to general permission

- (1) A provision in any of subparts DB to DZ may supplement the general permission. In that case, a person to whom the provision applies does not have to satisfy the general permission to be allowed a deduction.

Express reference needed to supplement

- (2) A provision in any of subparts DB to DZ takes effect to supplement the general permission only if it expressly states that it supplements the general permission.

Relationship of general limitations to supplements to general permission

- (3) Each of the general limitations overrides a supplement to the general permission in any of subparts DB to DZ, unless the provision creating the supplement expressly states otherwise.

Relationship between other specific provisions and general permission or general limitations

- (4) A provision in any of subparts DB to DZ may override any 1 or more of the general permission and the general limitations.

Express reference needed to override

- (5) A provision in any of subparts DB to DZ takes effect to override the general permission or a general limitation only if it expressly states that—
- (a) it overrides the general permission or the relevant limitation; or
 - (b) the general permission or the relevant limitation does not apply.

Part E

- (6) No provision in Part E (Timing and quantifying rules) supplements the general permission or overrides the general permission or a general limitation.

4. Section DB 1 contains an exclusion from deductibility for certain amounts of interest:

DB 1 Taxes, other than GST, and penalties

No deduction

- (1) A person is denied a deduction for the following:
- (a) income tax;
 - (b) a tax imposed in a country or territory outside New Zealand that is substantially the same as income tax;
 - (bb) an amount withheld under section 1471 or 1472 of the Internal Revenue Code of 1986 (USA), as amended from time to time;
 - (c) ancillary tax, unless listed in subsection (2):

- (d) a civil penalty under Part 9 of the Tax Administration Act 1994;
- (e) a tax, a penalty, or interest on unpaid tax that is—
 - (i) payable under the laws of a country or territory outside New Zealand; and
 - (ii) substantially the same as a civil penalty as defined in section 3(1) of the Tax Administration Act 1994, or a criminal penalty under Part 9 of the Act, or interest imposed under Part 7 of the Act.

Some ancillary tax excluded

- (2) Subsection (1) does not apply to—
- (a) pay-as-you-earn (PAYE);
 - (b) fringe benefit tax (FBT);
 - (c) employer's superannuation contribution tax (ESCT);
 - (d) resident withholding tax (RWT);
 - (e) non-resident withholding tax (NRWT).

Link with subpart DA

- (3) This section overrides the general permission.

5. Section DB 6 allows a deduction for interest incurred:

DB 6 Interest: not capital expenditure

Deduction

- (1) A person is allowed a deduction for interest incurred.

Exclusion

- (2) Subsection (1) does not apply to interest for which a person is denied a deduction under section DB 1.

Conduit financing arrangements

- (3) [Repealed]

Link with subpart DA

- (4) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

6. Section DB 7 allows a deduction for interest incurred by companies:

DB 7 Interest: most companies need no nexus with income

Deduction

- (1) A company is allowed a deduction for interest incurred.

Exclusion: qualifying company

- (2) Subsection (1) does not apply to a qualifying company.

Exclusion: exempt income

- (3) If a company (**company A**) derives exempt income or another company (**company B**) that is part of the same wholly-owned group of

companies derives exempt income, subsection (1) applies to company A only if all the exempt income is 1 or more of the following:

- (a) dividends; or
- (b) income exempted under section CW 58 (Disposal of companies' own shares); or
- (c) income exempted under section CW 60 (Stake money) and ancillary to the company's business of breeding.

Exclusion: non-resident company

- (4) If a company is a non-resident company, subsection (1) applies only to the extent to which the company incurs interest in the course of carrying on a business through a fixed establishment in New Zealand.

Exclusion: interest related to tax

- (5) Subsection (1) does not apply to interest for which a person is denied a deduction under section DB 1.

Consolidated groups

- (6) Section FM 12 (Expenditure when deduction would be denied to consolidated group) may apply to allow a deduction under this section to a company that is part of a consolidated group.

Relationship with subpart DG

- (6B) Subpart DG (Expenditure related to use of certain assets) overrides this section for expenditure to which that subpart relates.

Conduit financing arrangements

- (7) *[Repealed]*

Link with subpart DA

- (8) This section supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply.

- 7. Section DB 8 allows a deduction for interest on money borrowed to acquire shares in group companies:

DB 8 Interest: money borrowed to acquire shares in group companies

Deduction: borrowing to acquire group company shares

- (1) A company is allowed a deduction for interest incurred on money borrowed to acquire shares in another company that is part of the same group of companies.

Exclusion: group not in existence at year end

- (2) Subsection (1) does not apply if the 2 companies are not part of the same group of companies at the end of the tax year that corresponds to the income year in which the deduction is allowed.

Deduction: interest after resident's restricted amalgamation

- (3) A company is allowed a deduction for interest incurred on money borrowed to acquire shares in

another company that has ended its existence on a resident's restricted amalgamation.

Exclusion: group not in existence immediately before resident's restricted amalgamation

- (4) Subsection (3) does not apply if the 2 companies were not part of the same group of companies immediately before the resident's restricted amalgamation.

Application from income year of resident's restricted amalgamation

- (5) Subsection (3) applies in the income year in which the resident's restricted amalgamation occurs and in later income years.

Consolidated groups

- (6) Section FM 12 (Expenditure when deduction would be denied to consolidated group) may apply to allow a deduction under this section to a company that is part of a consolidated group.

Relationship with subpart DG

- (6B) Subpart DG (Expenditure related to use of certain assets) overrides this section for expenditure to which that subpart relates.

Conduit financing arrangements

- (7) *[Repealed]*

Link with subpart DA

- (8) This section supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply.

- 8. Section HG 2 provides that partnerships are transparent for income tax purposes:

HG 2 Partnerships are transparent

Look-through in accordance with share

- (1) For the purposes of a partner's liabilities and obligations under this Act in their capacity of partner of a partnership, unless the context requires otherwise,—
 - (a) the partner is treated as carrying on an activity carried on by the partnership, and having a status, intention, and purpose of the partnership, and the partnership is treated as not carrying on the activity or having the status, intention, or purpose;
 - (b) the partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property;
 - (c) the partner is treated as being party to an arrangement to which the partnership is a party, in proportion to the partner's partnership share, and the partnership is treated as not being a party to the arrangement;

- (d) the partner is treated as doing a thing and being entitled to a thing that the partnership does or is entitled to, in proportion to the partner's partnership share, and the partnership is treated as not doing the thing or being entitled to the thing.

No streaming

- (2) Despite subsection (1), for a partner in their capacity of partner of a partnership, the amount of income, tax credit, rebate, gain, expenditure, or loss that they have from a particular source, or of a particular nature, is calculated by multiplying the total income, tax credit, rebate, gain, expenditure, or loss of the partners of the partnership from the particular source or of the particular nature by the partner's partnership share in the partnership's income.

Expenditure or loss previously incurred

- (3) A partner of a partnership may be treated as incurring an expenditure or loss which the partnership incurs ignoring this section, despite the partner not being a partner at the time the expenditure or loss is incurred. This subsection does not allow 2 deductions for 1 expenditure or loss.

Excluded amounts

- (4) Subsection (2) does not apply to the following amounts:
 - (a) expenditure or loss that relates to a person entering a partnership by acquiring partner's interests disposed of by another partner, to the extent to which sections HG 5 to HG 10 do not apply to the partner's interests:
 - (b) supplementary dividends, to the extent to which subpart LP (Tax credits for supplementary dividends) applies:
 - (c) *[Repealed]*
 - (d) imputation credits, to the extent to which section LE 6 (Partners in partnerships) applies:
 - (e) FDP credits, to the extent to which section LF 4 (Partners in partnerships) applies.

- 9. Section IC 5 provides for when a company may make a subvention payment to another group company:

IC 5 Company B using company A's tax loss

Requirements

- (1) Company A may make a tax loss available to company B to subtract from its net income under section IA 3(2) (Using tax losses in tax year) only if—
 - (a) company A and company B have minimum common ownership for the relevant period as set out in sections IC 2(2) and IC 6; and

- (b) company A meets the residence requirements of section IC 7; and
- (c) company A has the required continuity of ownership under section IC 2(1) and, if it applies, section IC 10(2)(a); and
- (d) the amount falls within the limits set by section IC 8(1) and (2); and
- (e) the payment and notification requirements of section IC 9 are met.

Method: election or subvention payment

- (2) Having met all the requirements set out in subsection (1), company A may—
 - (a) choose to make a tax loss that it has in a tax year available to company B to use in the tax year, notifying the Commissioner as described in section IC 9; or
 - (b) agree with company B that company B should bear the amount of company A's tax loss, or take a share in it, in return for a payment by company B to company A by the date set out in section IC 9; or
 - (c) apply both paragraphs (a) and (b) in relation to the tax loss.

Amounts used in tax year

- (3) Company B must subtract the amount of the tax loss referred to in subsection (2)(a) or the payment referred to in subsection (2)(b), as applicable, from its net income for the tax year in relation to which company A makes the amount available or receives the payment.

When decisions made

- (4) If company A chooses to make the amount available to company B under subsection (2)(a), the decision is irrevocable.

Nature of payment

- (5) To the extent to which an amount of tax loss is subtracted from net income, a payment from company B to company A under subsection (2)(b) is not a dividend.

Part-year tax losses

- (6) Sections IP 4 and IP 5 (which relate to losses in part-years) modify this section for part-year calculations.

Tax years before 1981–82 and between 1981–82 and 1991–92

- (7) Section IZ 7 (Grouping tax losses for tax years before 1981–82 and between 1981–82 and 1991–92) modifies the requirements of—
 - (a) subsection (1)(a) for a tax loss component that arises in tax years between 1981–82 and 1991–92; and
 - (b) subsection (1)(b) for a tax loss component that arises in tax years before the 1991–92 tax year; and

- (c) subsection (1)(a) for a tax loss component that arises in tax years before the 1981–82 tax year.

Partnership Act 1908

10. Section 23 of the Partnership Act 1908 provides:

23 Partnership property

- (1) All property and rights and interests in property originally brought into the partnership stock, or acquired (whether by purchase or otherwise) on account of the firm or for the purposes and in the course of the partnership business, are called in this Act **partnership property**, and must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.
- (2) Provided that the legal estate or interest in any land which belongs to the partnership shall devolve according to the nature and tenure thereof and the general rules of law thereto applicable, but in trust, so far as necessary, for the persons beneficially interested in the land under this section.
- (3) Where co-owners of an estate or interest in any land not being itself partnership property are partners as to profits made by the use of that land or estate, and purchase other land or estate out of the profits to be used in like manner, the land or estate so purchased belongs to them, in the absence of an agreement to the contrary, not as partners, but as co-owners for the same respective estates and interests as are held by them in the land or estate first mentioned at the date of the purchase

11. Section 27 of the Partnership Act 1908 provides:

27 Rules as to interests and duties of partners

The interests of partners in the partnership property, and their rights and duties in relation to the partnership, shall be determined, subject to any agreement (express or implied) between the partners, by the following rules:

- (a) all the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses, whether of capital or otherwise, sustained by the firm:
- (b) the firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—
 - (i) in the ordinary and proper conduct of the business of the firm; or
 - (ii) in or about anything necessarily done for the preservation of the business or property of the firm:

- (c) a partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe is entitled to interest at the rate of 5% per annum from the date of the payment or advance:
- (d) a partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him:
- (e) every partner may take part in the management of the partnership business:
- (f) no partner shall be entitled to remuneration for acting in the partnership business:
- (g) no person may be introduced as a partner without the consent of all existing partners:
- (h) any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners:
- (i) the partnership books are to be kept at the place of business of the partnership (or the principal place if there is more than one), and every partner may when he thinks fit have access to and inspect and copy any of them.

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

PRIVACY (INFORMATION SHARING AGREEMENT BETWEEN INLAND REVENUE AND NEW ZEALAND POLICE) AMENDMENT ORDER 2015

The Privacy (Information Sharing Agreement Between Inland Revenue and New Zealand Police) Amendment Order 2015 amends an existing information sharing agreement between Inland Revenue and the New Zealand Police¹. Under the agreement, Inland Revenue can share personal information with the New Zealand Police for the prevention, detection, investigation of, or to use as evidence of, a serious crime. Amendments have been made to the original agreement to clarify the intent and operational matters, as well as correct minor errors. These include:

- providing greater clarity around Inland Revenue's ability to proactively share personal information outside of the categories of information that may be requested by New Zealand Police;
- amending certain definitions in the information sharing agreement. In general, the amendments note that current and previous personal information may be provided; and
- updating certain operational procedures relating to the sharing of personal information, particularly in relation to the physical receipt of information by New Zealand Police. This places the agreement in line with the requirements relating to the production of evidence in court proceedings, for example, hard drives and images.

The regulation amends the existing agreement from 1 May 2015, and can be found at <http://www.ird.govt.nz/aboutir/agreements/agreement-police/>

Privacy (Information Sharing Agreement Between Inland Revenue and New Zealand Police) Amendment Order 2015 (LI 2015/62)

¹ The *Tax Information Bulletin* item on the original agreement can be found in Vol 26, No 6 (July 2014), p42, or at <http://www.ird.govt.nz/technical-tax/legislation/2014/orders-in-council/oic-2014-privacy-order.html>

TAXATION (KIWISAVER HOMESTART AND REMEDIAL MATTERS) ACT 2015

The Taxation (KiwiSaver HomeStart and Remedial Matters) Bill was introduced on 1 December 2014. It received its first reading on 4 December 2014, its second reading on 24 March 2015 and its third reading on 26 March 2015. The new Act received Royal assent on 31 March 2015. It amends the KiwiSaver Act 2006 and the Income Tax Act 2007.

The new legislation allows eligible KiwiSaver members to withdraw their member tax credits when purchasing a new home, and corrects errors in the tax, social policy and KiwiSaver treatment of income replacement payments paid under the Veterans' Support Act 2014.

WITHDRAWAL OF MEMBER TAX CREDITS FOR FIRST HOMES

Schedule 1 of the KiwiSaver Act 2006, clauses 8(4)(a) and 8(7)(a)

The Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 implements part of the Government's HomeStart support package for first home buyers, announced in August 2014.

The principal measure allows eligible KiwiSaver members who are withdrawing their funds to purchase their first home to withdraw their member tax credits as well.

An ordering rule has been included to clarify which components of a member's fund are withdrawn when a partial withdrawal is made.

Background

Under the previous rules, eligible KiwiSaver members purchasing their first home were able to withdraw the contributions they and their employers had made to their KiwiSaver funds but not member tax credits paid by the Government or the \$1,000 kick-start.

The new rules allow eligible members also to withdraw their Government member tax credits.

The Government's \$1,000 kick-start cannot be withdrawn, to keep the member's account open and active after the withdrawal of eligible funds.

Key features

- Clause 8(4)(a) of Schedule 1 of the KiwiSaver Act 2006 has been amended so that only the Government's kick-start payments need to remain in a member's account to ensure the account remains open.

- Clause 8(7)(a) has been amended to clarify that when funds are withdrawn they are taken first from funds contributed by the member and their employer, and second from the member tax credits.

Application date

The amendments came into force on 1 April 2015.

KIWISAVER WITHDRAWALS FOR FIRST HOME BUYERS

Schedule 1 of the KiwiSaver Act 2006, clause 8(7)(c)

The KiwiSaver Act 2006 has been amended so a KiwiSaver first home withdrawal amount can be used to make payments before the purchase agreement on a new home goes unconditional (to pay a deposit, for example).

Background

Under the previous rules, eligible KiwiSaver members who wanted to withdraw their savings to purchase their first home were unable to do so until the agreement for sale and purchase became unconditional. Consequently, whenever the agreement for sale and purchase was still subject to conditions at the time a deposit was to be paid, a first home buyer was unable to use their KiwiSaver savings to pay that deposit.

Key features

The KiwiSaver Scheme Rules in Schedule 1 of the KiwiSaver Act 2006 have been amended to allow KiwiSaver members to withdraw their savings to purchase their first home before the agreement is unconditional, provided any payment is made to "a stakeholder". That person is usually the vendor's solicitor, who can only release the funds in appropriate circumstances. Thus, first home buyers whose purchase agreements are conditional will be able to withdraw their KiwiSaver savings to pay a deposit.

Wherever possible, the objective is for KiwiSaver savings that are withdrawn under this rule to be used to purchase a home or returned to the KiwiSaver funds manager.

When the purchase agreement is unconditional, the original rules continue to apply, except that a solicitor's undertaking is now compulsory. Before the KiwiSaver savings can be withdrawn, the purchaser's solicitor must provide an undertaking to the funds manager that the withdrawal will either be paid to the vendors as part of the purchase price or will be repaid to the funds manager on behalf of the member if settlement of the agreement is not completed in accordance with the agreement.

When the agreement is conditional, before the KiwiSaver savings can be withdrawn, the purchaser's solicitor must provide an undertaking to the funds manager that:

- payment of any amount of the withdrawal will be held by a stakeholder;
- the stakeholder is obliged to hold the amount while the agreement is conditional;
- the stakeholder is obliged to repay the amount to the purchaser's solicitor if settlement of the agreement is not completed in accordance with the agreement, except when non-completion is due to the purchaser's default; and
- when settlement does not occur, the purchaser's solicitor will repay the amount they receive from the vendor's solicitor to the funds manager on behalf of the member.

Application date

The amendment came into force on 1 June 2015.

Detailed analysis

An agreement is conditional if it describes actions or events that must take place before the purchase can be settled.

Form of solicitor's undertaking

When the purchase agreement is unconditional, the forms of undertaking currently used by the industry can continue to be used.

When the purchase agreement is conditional, the Government interprets the Act to require the solicitor to undertake no more than what the solicitor can control:

- The solicitor is being asked to undertake that the stakeholder is under an obligation to hold the payment while the agreement is conditional, not that the stakeholder will actually do so in practice.
- If the agreement fails to settle other than by reason of the purchaser's default, the solicitor is being asked to undertake that the stakeholder is under an obligation to repay the amount owed, not that the stakeholder will actually repay that amount.

Consequently, the following form of undertaking is considered to satisfy the Act:

"We undertake to you that:

1. as at the date of this undertaking, the purchase agreement is conditional;
2. payment of any funds that we receive on behalf of the Member (Funds) will be held by a stakeholder who is obliged—
 - a) to hold the Funds while the agreement is conditional; and

- b) to repay the Funds to us if settlement of the agreement is not completed in accordance with the agreement by the due date or any extended due date, except where settlement is not completed due to the Member's default; and

3. we will repay to you as soon as practicable on account of the Member any Funds that the stakeholder repays to us.

The relevant undertakings above are restricted to confirming that the stakeholder is under an obligation to hold the funds while the agreement is conditional and to confirming that the stakeholder is under an obligation to repay funds to us in the event that settlement of the agreement is not completed. We make no undertaking that the stakeholder will actually do so in either case and accept no liability in the event that the stakeholder acts in breach of their obligations."

FIRST HOME WITHDRAWAL ONLY AVAILABLE FOR NEW ZEALAND HOMES

Schedule 1 of the KiwiSaver Act 2006, clause 8(3)

The first home withdrawal rules were previously silent on where a house could be bought. The only New Zealand-based restriction was a requirement that a member's funds were paid to a practitioner who holds a New Zealand practising certificate.

The new rules make it clear that the withdrawal can only be made for the purchase of an estate in land located in New Zealand.

Background

Providers interpreted the previous rules inconsistently, with some approving withdrawals for a first home overseas while others declined them. The member tax credit changes introduced by the Taxation (KiwiSaver HomeStart and Remedial Matters) Bill 2014 increased the importance of clarifying this rule. If the member tax credit could be withdrawn for a home overseas, this would have created an opportunity for permanent migrants who would otherwise not be entitled to withdraw the member tax credit.

By limiting the first home withdrawal to purchases in New Zealand, the new rules minimise the complexity and costs associated with monitoring transactions in overseas jurisdictions. They also reduce the risk of misuse of the early withdrawal provision since providers have familiarity with New Zealand sale and purchase documents.

Key feature

Under clause 8(3) of Schedule 1 of the KiwiSaver Act 2006, home withdrawals can only be made for the purposes of purchasing a first home in New Zealand.

Application date

The amendment came into force for first home withdrawal applications made on and after 1 April 2015.

FIRST HOME WITHDRAWAL AVAILABLE FOR HOMES ON MĀORI LAND

Schedule 1 of the KiwiSaver Act 2006, clauses 8(3B), 8(6) and 8(7)(c)(iii)

Changes have been made to make it clear that a first home withdrawal under the KiwiSaver member rules is available to purchase or build a home on Māori land.

Background

Previously a first home withdrawal under the KiwiSaver rules was only available for the purchase of “an estate in land”. This requirement generally excluded people with an interest in Māori land because they are not purchasing an “estate”.

The rules also stated that a member with a previous interest in land, including any interest as a tenant-in-common, was not eligible for a first home withdrawal. A narrow interpretation of the rules automatically excluded Māori land owners because of the tenancy-in-common status of Māori land, despite the fact that the individual interest is extremely small and generally cannot be economically realised.

A change to specifically recognise interests in Māori land was required to align with the original policy intent of KiwiSaver, and the policy intent of the Kāinga Whenua funding programmes and the Government’s Māori home ownership and land use goals set out in He Whare Āhuru He Oranga Tāngata – the Māori Housing Strategy and He Kai Kei Aku Ringa – The Crown-Māori economic growth partnership.

Key features

First home withdrawals can be made to purchase a dwellinghouse on Māori land.

The dwellinghouse must be intended as the principal place of residence for the member.

Prior ownership of a dwellinghouse on Māori land and an existing interest in Māori land is not a bar to accessing a first home withdrawal.

Evidence of the right to occupy the land is required, such as a licence to occupy or an occupation order.

Application date

The amendment came into force for first home withdrawal applications made on and after 1 April 2015.

Detailed analysis

The amendment has been made, in response to evidence indicating that applications for first home withdrawals to purchase or build a home on Māori land were generally being declined because the first home withdrawal was tied to the purchase of “an estate in land”.

Meaning of “estate in land”

“Estate” is defined in the KiwiSaver rules as “a fee simple estate, a leasehold estate or a stratum estate” and comprises the home *and* the land on which the home is situated (or the right to use the land). This requirement generally excludes people with an interest in Māori land because while they have a right to use the land on which the home is situated, they do not generally purchase the land or pay for the right to use it. Only the home is purchased and the land usually remains with all of the owners as Māori land.

The previous rules stated that members with a previous or existing interest in an estate in land were not generally eligible for a first home withdrawal. A narrow interpretation of this rule automatically excluded Māori land owners because of their existing interest in an estate in land due to the tenancy-in-common status of Māori land. This rule was a barrier despite the fact that the individual interest in the estate in land is extremely small and generally cannot be economically realised.

Inclusion of “dwellinghouse”

It is now possible to make a first home withdrawal in respect of a dwellinghouse on Māori land. The dwellinghouse must be the principal place of residence for the member or the member and the member’s family and the member must have evidence of the right to occupy the land on which the dwellinghouse is situated.

Evidence of right to occupy

In addition to the existing conditions listed in clause 8(7), the fund manager may require from the member’s solicitor or conveyancing practitioner evidence of the right to occupy the land. This could be a licence to occupy or an occupation order.

Previous ownership

The existing eligibility rules provide that a KiwiSaver member can access KiwiSaver funds to purchase a first home if the member:

- has not made a withdrawal from any KiwiSaver scheme to buy a home;
- has never owned a property (this does not include previously holding an estate in land as a bare trustee or a leasehold estate); or
- can demonstrate that they are in the same financial situation as a first-home buyer.

Under the amendments, the first of those eligibility rules is unchanged but the second eligibility rule has been adapted to deal with the special circumstances relating to interests in Māori land.

If a person holds or has held an estate in land which is an interest in Māori land, it is ignored under clauses 8(3)(b)(ii) and 8(3B)(b)(ii). That includes:

- a dwellinghouse on Māori land (which is broadly analogous to a leasehold estate, which is already excluded from the eligibility rules under clause 8(5)(ab)); and
- an existing interest in Māori land, such as an interest as a tenant-in-common, which cannot be economically realised.

If the person with an interest in Māori land holds any other estate in land, such as a fee simple estate, they are not eligible for a first home withdrawal unless they can demonstrate that they are in the same financial situation as a first-home buyer. This approach is consistent with the existing eligibility rules.

COMPLYING SUPERANNUATION FUND MEMBERSHIP

Schedule 1 of the KiwiSaver Act 2006, clause 8(1)(ab)

The previous first home withdrawal rules included an eligibility period of at least three years in one or more KiwiSaver schemes. The rules have been extended to recognise previous membership in any complying superannuation fund of three years or more as counting towards the three years eligibility period for a first home withdrawal.

The policy intent is that *any* previous period of membership in a complying superannuation fund should count towards the three-year eligibility period when a member transfers to KiwiSaver.

Background

A complying superannuation fund is a registered superannuation scheme with membership rules broadly in line with the KiwiSaver rules. Under the KiwiSaver Act, membership of a complying scheme is broadly treated as equivalent to membership of KiwiSaver.

The first home withdrawal rules in the KiwiSaver Act state that an individual can make a withdrawal if they have been a KiwiSaver member for at least three years. The rules did not explicitly recognise previous years of membership in another complying superannuation scheme. If a complying superannuation scheme member transferred their funds to KiwiSaver, the rules implied that the member needed to serve a further three years in a KiwiSaver scheme before making a first home withdrawal.

Key features

Three years' membership in a complying superannuation scheme before transferring to KiwiSaver counts towards the eligibility period for a KiwiSaver first home withdrawal.

The policy intent is that *any* prior period of membership in a complying superannuation fund should count towards the three-year eligibility period when the member transfers to KiwiSaver.

Application date

The amendment came into force for first home withdrawal applications made on and after 1 April 2015.

TRANS-TASMAN PORTABILITY ARRANGEMENTS

Schedule 1 of the KiwiSaver Act 2006, clause 14B(1)

New rules that apply to trans-Tasman portability of savings make it clear that they apply only to the ability to withdraw funds upon permanent emigration and are not an exception to the other KiwiSaver early withdrawal provisions.

Background

In mid-2013, the trans-Tasman savings portability arrangements between New Zealand and Australia came into effect. Under the arrangements, a KiwiSaver member cannot withdraw their retirement savings in cash upon permanent migration to Australia, as can be done if a member migrates to a country other than Australia. Rather, the member may transfer their savings to an Australian complying superannuation scheme. Participation is voluntary for members (who can choose to keep their KiwiSaver accounts open if they wish) and providers (who are not obliged to accept KiwiSaver funds).

Previously, the trans-Tasman portability rule in the KiwiSaver Act stated "a member may not withdraw **any amount** ... after the member's permanent emigration to Australia ..." (emphasis added). This could be interpreted as preventing a KiwiSaver member who has permanently migrated to Australia from making a withdrawal in any of the other circumstances provided for in the KiwiSaver Act

(for example, withdrawal upon retirement or death, or withdrawal in the case of serious illness).

The portability rule has been amended to clarify that it is only an exception to the ability to withdraw funds in cash upon permanent emigration (not an exception to the other KiwiSaver early withdrawal rules).

Key features

In circumstances when a member has permanently migrated to Australia, but has chosen to retain their KiwiSaver account, the trans-Tasman savings portability arrangements:

- are only an exception to the ability to withdraw funds upon permanent emigration; and
- do not prevent any other withdrawal provided for in Schedule 1 of the KiwiSaver Act (although there may be other reasons why a withdrawal may not be allowed, for example, the New Zealand-based restriction for first homes).

Application date

The amendment came into force for early withdrawal applications made on and after 1 April 2015.

PROTECTION FROM NON-COMPLIANCE

Section 239 of the KiwiSaver Act 2006

The Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 made changes to the KiwiSaver Act 2006 on 1 April 2015. Section 239 ensures that KiwiSaver providers are not at risk of being in breach of securities law for documents that had already been issued or issued before 1 June 2015.

Key features

Prospectuses and investment statements issued under the Securities Act 1978 will not have to reflect the changes made by the Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 if they were issued before 1 June 2015.

Product disclosure statements issued under the Financial Markets Conduct Act 2013 and lodged before 1 June will not have to be updated to reflect the changes made in the Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 until 1 April 2016.

Application date

The amendment came into force on 1 April 2015.

VETERAN INCOME REPLACEMENT PAYMENTS

Sections CF 1(1), CW 28(1)(a), MA 7(3), and RD 5(6) of the Income Tax Act 2007 and sections 4 and 14 of the KiwiSaver Act 2006

The new Act introduces amendments to the Income Tax Act 2007 and the KiwiSaver Act 2006 that correct the tax, social policy and KiwiSaver treatment of income replacement payments paid under the Veterans' Support Act 2014. The corrections ensure the payments are treated the same as ACC earnings-related "weekly compensation" payments for tax, social policy and KiwiSaver purposes.

Background

The Veterans' Support Act 2014 introduced two new support schemes for veterans who have suffered as a result of their service.

Two types of payment were included under Scheme One and Scheme Two:

- impairment compensation payments (for example, the disablement pension); and
- income replacement payments (for example, a veteran's weekly income compensation).

The policy intention was for veteran income replacement payments to be treated the same as ACC weekly compensation payments for tax, social policy and KiwiSaver purposes. ACC weekly compensation payments are treated as taxable, subject to PAYE and are included in social policy calculations. In addition, KiwiSaver deductions can be made from the payments, but they are not subject to the KiwiSaver auto-enrolment and compulsory employer contributions rules.

However, the Veterans' Support Act 2014 did not apply the correct tax, social policy and KiwiSaver treatments to the veteran income replacement payments. The Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 introduced amendments to ensure the correct policy outcome is achieved.

TAX TREATMENT OF INCOME REPLACEMENT PAYMENTS

Sections CF 1(1) and CW 28(1)(a) of the Income Tax Act 2007

Amendments have been made to sections CF 1 and CW 28 of the Income Tax Act 2007 to ensure veteran income replacement payments are treated as taxable income. Payments that are taxable income are also included in social policy calculations.

Other payments under the Veterans' Support Act 2014 that relate to impairment compensation, remain tax-exempt.

Background

Income replacement payments contained in the Veterans' Support Act 2014 are intended to be treated the same for tax and social policy purposes as ACC weekly compensation payments. ACC weekly compensation payments are treated as compensation income in section CF 1, and are included in a list of payments specifically excluded from being exempt income in section CW 34 of the Income Tax Act 2007. These treatments ensure ACC weekly compensation payments are treated as taxable income. They also ensure the payments are included in social policy calculations. Changes made in the Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 ensure income replacement payments under the Veterans' Support Act 2014 are also treated as taxable "compensation income" and are included in social policy calculations.

Key features

Amendments have been made to section CF 1(1) in order to add weekly compensation, weekly income compensation, and retirement lump sums for veterans, and weekly compensation to veterans' spouses, partners, children and dependants as compensation payments to the list of benefits, pensions, compensation payments and government grants that are treated as income. This ensures these payments are taxed and also included in social policy calculations. Thus, the payment amounts will increase affected veterans' and deceased veterans' spouses, partners, children and dependants' student loan and child support obligations, and reduce their Working for Families entitlements.

An amendment to section CW 28(1)(a) was made in the Veterans' Support Act 2014 to add veteran weekly compensation to the list of payments that are excluded from exempt income under this section. The Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 further amends section CW 28(1)(a) by adding weekly income compensation, retirement lump sums for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants to this list. This ensures that all of these payments are treated as taxable income and are included in social policy calculations. Other entitlements (such as the disablement pension) under the Veterans' Support Act 2014 remain tax-exempt income.

Note that under section YD 4(18) income replacement payments are treated as having a New Zealand source. When a veteran receiving the payment is a tax resident overseas, a double tax agreement may affect how these payments are taxed.

Application dates

The amendments that relate to weekly compensation, weekly income compensation for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants came into force on the date of enactment, being 31 March 2015.

The amendments that relate to retirement lump sum payments for veterans came into force on 7 December 2014, the commencement date of Scheme One in the Veterans' Support Act 2014.

PAYE AND KIWISAVER TREATMENT OF INCOME REPLACEMENT PAYMENTS

Section RD 5(6) of the Income Tax Act 2007 and sections 4 and 14 of the KiwiSaver Act 2006

Amendments have been made to section RD 5 of the Income Tax Act 2007 to ensure veteran income replacement payments are subject to PAYE, and KiwiSaver deductions can be made from the payments.

Amendments have been made to sections 4 and 14 of the KiwiSaver Act 2006 to ensure the KiwiSaver auto-enrolment and compulsory employer contributions rules do not apply to veteran income replacement payments.

Background

The policy intention is that veteran income replacement payments will be subject to PAYE, and KiwiSaver deductions can be made from the payments, but they are not subject to the KiwiSaver auto-enrolment and compulsory employer contributions rules. This is the same treatment that applies to ACC weekly compensation payments.

Key features

Amendments have been made to section RD 5(6) of the Income Tax Act 2007 to add veteran weekly compensation, weekly income compensation, and retirement lump sums for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants to the list of benefits or grants treated as salary and wages. This ensures that veteran income replacement payments will be subject to PAYE, and KiwiSaver deductions can be made from these payments when the veteran joins KiwiSaver on their own behalf.

Amendments have been made to section 4 of the KiwiSaver Act 2006 to add weekly compensation, weekly income compensation, and retirement lump sums for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants to the list of payments treated as salary or wages that (for the purposes of subpart 3A of the KiwiSaver Act 2006) are excluded from the

compulsory employer contribution rules. This ensures that there is no requirement for compulsory employer contributions to be paid on KiwiSaver deductions made from these payments.

Amendments have been made to section 14 of the KiwiSaver Act 2006 to add weekly compensation and weekly income compensation for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants to the list of salary or wage income types that are not subject to the KiwiSaver automatic enrolment rules. This means there is no legal requirement to automatically enrol people receiving veteran income replacement payments in the KiwiSaver scheme.

Application dates

The amendments that relate to weekly compensation and weekly income compensation for veterans, and weekly compensation to deceased veterans' spouses, partners, children and dependants came into force on the date of enactment, being 31 March 2015.

The amendments that relate to retirement lump sum payments for veterans came into force on 7 December 2014, the commencement date of Scheme One in the Veterans' Support Act 2014.

CRITERIA FOR EARNINGS-RELATED WORKING FOR FAMILIES TAX CREDITS

Section MA 7(3) of the Income Tax Act 2007

An amendment has been made to section MA 7 of the Income Tax Act 2007 to ensure the surviving spouse or partner of a deceased veteran can continue to claim the deceased veteran's full-time earner-related Working for Families tax credits.

Background

People need to meet certain criteria to qualify to receive Working for Families tax credits. Recipients of the in-work tax credit (IWTC) and the minimum family tax credit (MFTC) are required to be full-time earners (work at least 20 hours if single, or at least 30 hours as a couple).

However, if a person is receiving an ACC earnings-related payment due to an incapacity, the hours the person worked before being injured count towards their hours of work for Working for Families purposes. In the event of their death, their spouse/partner can continue to receive the deceased person's payments and full-time earner-related tax credits (the IWTC and MFTC).

The policy intention is for weekly income compensation and weekly compensation for veterans and weekly compensation to deceased veterans' spouses or partners to

be treated the same as ACC earnings-related payments for Working for Families purposes.

An amendment to section MA 7(3) of the Income Tax Act 2007 contained in the Veterans' Support Act 2014 ensured that weekly compensation and weekly income compensation for veterans are treated as relating to an incapacity, and therefore the work hours test is modified for Working for Families purposes.

However, section MA 7(3) did not include weekly compensation payments to deceased veterans' spouses or partners. Therefore, these payments would not have been treated as relating to an incapacity for the purposes of section MA 7(2)(d). Hence, surviving spouses or partners would not have qualified to receive a deceased veteran's full-time earner-related Working for Families tax credits (IWTC or MFTC) without the amendment to section MA 7(3) in the Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015.

Key features

The amendment expands section MA 7(3) of the Income Tax Act 2007 to include weekly compensation payments to deceased veterans' spouses or partners.

Section MA 7(2)(d) of the Income Tax Act 2007 modifies the Working for Families full-time earner rule for earnings-related payments made by ACC or Veterans' Affairs New Zealand to surviving spouses or partners of people who had been incapacitated.

The spouse or partner is treated as being employed for the number of hours their deceased partner or spouse would have been employed if they had not been incapacitated. The deceased person's assumed hours are added to the number of hours the spouse or partner has worked.

"Incapacity" referred to in section MA 7(2)(d) is defined as being an injury for which an ACC or veteran support payment listed in section MA 7(3) has, is or will be paid.

Application date

The amendment came into force on the date of enactment, being 31 March 2015.

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.

CPI ADJUSTMENT 15/01 FOR DETERMINATION DET 09/02: STANDARD-COST HOUSEHOLD SERVICE FOR CHILDCARE PROVIDERS

In accordance with the provisions of Determination DET 09/02, as published in *Tax Information Bulletin* Vol 21, No 4 (June 2009), Inland Revenue advises that, for the 2015 income year:

- a) the variable standard-cost component is confirmed at \$3.42 per hour per child; and
- b) the administration and record-keeping fixed standard-cost component is confirmed at \$334 per annum, for a full 52 weeks of childcare services provided.

The above amounts have been confirmed as a consequence of the annual movement of the Consumers Price Index for the 12 months to March 2015, which showed a small increase of 0.1%. For childcare providers who have a standard 31 March balance date, these amounts apply for the period from 1 April 2014 to 31 March 2015.

CPI ADJUSTMENT 15/02 FOR DETERMINATION DET 05/03: STANDARD-COST HOUSEHOLD SERVICE FOR BOARDING SERVICE PROVIDERS

In accordance with the provisions of Determination DET 05/03, as published in *Tax Information Bulletin* Vol 17, No 10 (December 2005), Inland Revenue advises that, for the 2015 income year:

- a) the weekly variable standard-cost for one to two boarders is confirmed at \$254 each; and
- b) the weekly variable standard-cost for third and subsequent number of boarders is confirmed at \$208 each.

The above amounts have been confirmed as a consequence of the annual movement of the Consumers Price Index for the 12 months to March 2015, which showed an increase of 0.1%. For boarding service providers who have a standard 31 March balance date, these amounts apply for the period from 1 April 2014 to 31 March 2015.

SPECIAL DETERMINATION S35: VALUATION OF SHARES ISSUED BY BANK FOLLOWING A CONVERSION EVENT

This determination may be cited as Special Determination S35: Valuation of Shares issued by Bank following a conversion event.

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

1. This determination relates to a funding transaction involving the issue of Notes by Bank to Issuer. The Notes will contain a conversion mechanism, in order to allow them to be recognised as Additional Tier 1 capital for the purposes of the Reserve Bank of New Zealand (RBNZ) framework relating to the capital adequacy of banks.
2. Bank has entered into a Deed Poll, which sets out the steps that will occur in the event that a Trigger Event occurs, requiring conversion of the Notes.
3. If a Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably converted into ordinary shares in Bank.
4. The Arrangement is the subject of private ruling BR Prv 15/10 issued on 9 April 2015, and is fully described in that ruling.
5. The share subscription provided for in the Deed Poll is a financial arrangement (as defined in s EW 3) and an “agreement for the sale and purchase of property or services” (as defined in s YA 1). The Notes and the share subscription are, together, a wider financial arrangement.

2. Reference

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

3. Scope of determination

1. This determination applies to a funding transaction involving the issue of Notes by Bank to Issuer. Bank has entered into a Deed Poll, which sets out the steps that will occur in the event that a Trigger Event occurs, requiring conversion of the Notes into shares in Bank.
2. If a Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably converted into shares in Bank. In summary, the steps for the conversion of the Notes will be as follows:
 - a) Each Note (subject to conversion) will become immediately due and payable and Bank will be required to repay the Face Value of the Note to Issuer. Bank will repay this amount by applying it on Issuer’s behalf in payment for the ordinary

shares referred to in paragraph (b) below.

- b) Under the terms of the Deed Poll, Issuer will be required to pay a sum to Bank, to subscribe for ordinary shares in Bank, equal to the face value of each Note converted.
 - c) The number of ordinary shares in Bank to be subscribed for will be calculated in accordance with a formula set out in the Deed Poll.
3. This determination applies in the situation that shares are issued by Bank to Issuer following a Trigger Event, and the net tangible assets of Bank are positive immediately prior to the conversion of Notes into ordinary shares in Bank (such that the “NTA” item in the “Value per Share” formula as set out in the Deed Poll is not deemed to be NZ\$1,000,000) to determine the value of the shares for the purposes of the financial arrangement rules.

4. Principle

1. The share subscription and the Notes are, together, a financial arrangement (as defined in s EW 3). The subscription for shares in Bank by Issuer contained in the Deed Poll is an “agreement for the sale and purchase of property and services” (as defined in s YA 1), as it is a conditional agreement to acquire property.
2. The share subscription is not a “short-term agreement for sale and purchase” (as defined in s YA 1), as settlement is not required to occur within 93 days of the Deed Poll being entered into. As such, it is not an excepted financial arrangement under s EW 5.
3. For the purposes of determining the consideration paid or payable under the financial arrangements rules, the value of the shares issued by Bank must be established under s EW 32. None of subs (3) to (5) apply to the share subscription.
4. Under s EW 32(6), the Commissioner is required to determine the value of the property. Both Bank and Issuer are required to use this amount.

5. Interpretation

In this determination, unless the context otherwise requires:

- “Bank” means the bank issuing the Notes.
- “Issuer” means a sister company of the Bank.
- “Trigger Event” has the meaning set out in the Deed Poll, as described in private ruling BR Prv 15/10 issued on 9 April 2015.

- “Notes” means the notes issued to Issuer as described in private ruling BR Prv 15/10 issued on 9 April 2015.

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

6. Method

1. The Arrangement does not involve the advancement or deferral of consideration.
2. For the purposes of s EW 32(6), the value of the shares issued by Bank is equal to the amount paid for those shares by Issuer provided the net tangible assets of Bank are positive immediately prior to the conversion of Notes into ordinary shares in Bank (and not deemed to be NZ\$1,000,000 in the “Value per Share” formula as set out in the Deed Poll).

7. Example

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

Following a Trigger Event, Notes with a face value of \$100 are to be converted to ordinary shares in Bank. Bank immediately repays the face value of the Notes to Issuer by applying the amount against the amount Issuer owes Bank to subscribe for the ordinary shares. Accordingly, Issuer pays an amount equal to the face value of the Notes to Bank to subscribe for ordinary shares in Bank. Bank has positive net tangible assets immediately prior to the conversion of the Notes.

Bank issues the number of shares to Issuer calculated in accordance with the formula set out in the Deed Poll. The value of the shares, for the purposes of s EW 32, is \$100.

This Determination is signed by me on the 9th day of April 2015.

Fiona Heiford
Manager (Taxpayer Rulings)

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK DETERMINATION 2015

This determination may be cited as “The National Average Market Values of Specified Livestock Determination, 2015”.

This determination is made in terms of section EC 15 of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2014–2015 income year.

For the purposes of section EC 15 of the Income Tax Act 2007 the national average market values of specified livestock, for the 2014–2015 income year, are as set out in the following table.

National average market values of specified livestock

Type of livestock	Classes of livestock	Average market value per head \$
Sheep		
	Ewe hoggets	88.00
	Ram and wether hoggets	83.00
	Two-tooth ewes	126.00
	Mixed-age ewes (rising three-year and four-year old ewes)	113.00
	Rising five-year and older ewes	90.00
	Mixed-age wethers	73.00
	Breeding rams	253.00
Beef cattle		
<i>Beef breeds and beef crosses:</i>		
	Rising one-year heifers	607.00
	Rising two-year heifers	940.00
	Mixed-age cows	1171.00
	Rising one-year steers and bulls	706.00
	Rising two-year steers and bulls	1104.00
	Rising three-year and older steers and bulls	1376.00
	Breeding bulls	2293.00
Dairy cattle		
<i>Friesian and related breeds, Jersey and other dairy breeds:</i>		
	Rising one-year heifers	681.00
	Rising two-year heifers	1324.00
	Mixed-age cows	1655.00

Type of livestock	Classes of livestock	Average market value per head \$
Dairy cattle	Rising one-year steers and bulls	501.00
	Rising two-year steers and bulls	900.00
	Rising three-year and older steers and bulls	1177.00
	Breeding bulls	1641.00
Deer		
<i>Red deer, wapiti, elk, and related crossbreeds:</i>		
	Rising one-year hinds	169.00
	Rising two-year hinds	333.00
	Mixed-age hinds	375.00
	Rising one-year stags	215.00
	Rising two-year and older stags (non-breeding)	434.00
	Breeding stags	1478.00
<i>Other breeds:</i>		
	Rising one-year hinds	89.00
	Rising two-year hinds	164.00
	Mixed-age hinds	201.00
	Rising one-year stags	127.00
	Rising two-year and older stags (non-breeding)	204.00
	Breeding stags	569.00
Goats		
<i>Angora and angora crosses (mohair producing):</i>		
	Rising one-year does	44.00
	Mixed-age does	55.00
	Rising one-year bucks (non-breeding)/wethers	42.00
	Bucks (non-breeding)/wethers over one year	50.00
	Breeding bucks	303.00
<i>Other fibre and meat producing goats (Cashmere or Cashgora producing):</i>		
	Rising one-year does	45.00
	Mixed-age does	57.00

Type of livestock	Classes of livestock	Average market value per head \$
Goats	Rising one-year bucks (non-breeding)/wethers	45.00
	Bucks (non-breeding)/wethers over one year	53.00
	Breeding bucks	285.00
<i>Milking (dairy) goats:</i>		
	Rising one-year does	320.00
	Does over one year	380.00
	Breeding bucks	250.00
	Other dairy goats	20.00
Pigs		
	Breeding sows less than one year of age	208.00
	Breeding sows over one year of age	268.00
	Breeding boars	330.00
	Weaners less than 10 weeks of age (excluding sucklings)	75.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	154.00
	Growing pigs over 17 weeks of age (baconers)	226.00

This determination is signed by me on the 11th day of May 2015.

Rob Wells

LTS Manager, Technical Standards

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.

DISPUTANT'S APPLICATION FOR FILING CHALLENGE OUT OF TIME DECLINED

Case	TRA 028/14; [2015] NZTRA 05
Decision date	13 April 2015
Act(s)	Tax Administration Act 1994
Keywords	Exceptional circumstances, challenge of refusal notice, s 89K

Summary

This is a decision of the Taxation Review Authority ("TRA") declining the disputant's application for an extension of time for filing challenge proceedings in relation to default assessments made by the Commissioner of Inland Revenue ("the Commissioner").

Facts

This was an application by the disputant for an extension of time for filing challenge proceedings based on exceptional circumstances. The challenge proceedings relate to default assessments issued by the Commissioner for two GST periods ending 30 November 2004 and 30 March 2006.

The disputant attempted to file a Notice of Proposed Adjustment ("NOPA") for these two periods outside of the statutory timeframes. The Commissioner's refusal notice declining to accept the NOPA was issued on 3 September 2014. The disputant filed a Notice of Claim in the TRA on 23 December 2014.

Section 89K(6) of the Tax Administration Act 1994 ("TAA") provides that a disputant is entitled to challenge a refusal notice issued by the Commissioner if proceedings are filed in the TRA "within two months of the notice's issue". Accordingly, the challenge should have been filed by 3 November 2014 to be brought within the requisite time period.

The Commissioner filed a memorandum stating that she will abide by the TRA's decision on the application. Accordingly, she did not file submissions on the matter.

Decision

Judge Sinclair found that while the events giving rise to the application were regrettable, the disputant had failed to establish exceptional circumstances and the application to extend time for filing and the challenge proceedings were dismissed.

The disputant contended that exceptional circumstances existed in this situation because the application to the TRA was delayed due to the disputant filing a judicial review proceeding in the High Court in error and it was only on 17 December 2014 that he was notified by the Commissioner that the proceeding should have been filed in the TRA.

Furthermore, the disputant claimed any delay was relatively minimal given that the Commissioner was aware of the case and did not advise the disputant of the error for many weeks after the application was filed in the High Court. The disputant went on to say that the Commissioner would have been under no illusion that the disputant was at all times disputing the assessments.

Judge Sinclair, however, found that the failure to commence the challenge proceedings within time came about because an error was made by the disputant's lawyers for which no explanation was given.

In confirming *Commissioner of Inland Revenue v Fuji Xerox NZ Limited* (2002) 20 NZTC, she held that the term "exceptional circumstance" has a specific statutory meaning being:

1. an event or circumstance beyond the control of a disputant;
2. that provides the disputant with a reasonable justification for not commencing a challenge to a disputable decision within the response period.

An act or omission of an agent (which in this case included the disputant’s lawyers) of a disputant will not be an exceptional circumstance unless certain conditions are satisfied. These are that:

1. the act or omission of the agent was caused by an event or circumstance beyond the control of the agent;
2. such event or circumstance could not have been anticipated; and
3. the effect of the act or circumstance could not have been avoided by compliance with accepted standards of business organisation and professional conduct.

Judge Sinclair found that the disputant’s situation was not an event or circumstance which was beyond the control of the disputant’s agent. She further found the situation was not an event or circumstance that could not have been anticipated. The situation could have been avoided by compliance with accepted standards of business organisation and professional conduct. She concluded, at [21], that the failure to file proceedings within time occurred simply because the requisite disputes procedure under the TAA was not followed.

She went on to state that it did not assist the disputant’s position that the Commissioner was aware from the history of the dispute proceedings that it was the disputant’s intention to dispute the assessments. Further, it was not relevant that the Commissioner took some weeks before she filed her protest to jurisdiction alerting the disputant to the error. The obligation was on the disputant and his advisors to ensure that the challenge proceedings were properly commenced.

HIGH COURT STRIKES OUT JUDICIAL REVIEW, FINDING IT TO BE AN ABUSE OF PROCESS

Case	John George Russell v Commissioner of Inland Revenue
Decision date	17 April 2015
Act(s)	Judicature Amendment Act 1972
Keywords	Abuse of process, maximum recovery, s 177B, Judicial Review

Summary

The High Court struck out John George Russell’s (“Mr Russell”) application for judicial review of the Commissioner of Inland Revenue’s (“the Commissioner”) decision declining his payment proposals.

Facts

Mr Russell has been assessed to owe tax of \$5,692,665.90 for the period 31 March 1985 to 31 March 2000 (inclusive). That amount owed has greatly increased through the application of penalties and interest. He has had summary judgment entered against him in the amount of \$367,204,207.41 plus costs and disbursements.

Mr Russell has made two instalment payment proposals and a lump sum proposal.

On 27 September 2006 at a judicial settlement conference, Mr Russell proposed to make instalment payments towards the assessments of \$1,000 per week. The Commissioner refused this proposal.

On 9 December 2012, Mr Russell again proposed to pay tax debt by instalments of \$1,000 per week for the rest of his life or until bankruptcy or mental incapacity. This was declined on 26 August 2013.

Mr Russell made an alternative offer on 2 September 2013 to pay a lump sum of \$150,000, which he could borrow against further income on the basis that the balance would be remitted. This was declined on 13 September 2013.

Mr Russell filed judicial review proceedings on 23 May 2014, seeking declarations that the Commissioner’s decisions declining his proposals were invalid, and an injunction preventing the Commissioner from taking any further steps to recover the debt.

The reasons for declining the 9 December 2012 proposal were set out in an internal memorandum of 10 July 2013. The offer proposed by Mr Russell was not considered to be a realistic offer as:

- the Commissioner was unable to write off any portion of the debt owed;
- there was no certainty or finality for either party;
- Mr Russell’s financial affairs were complex, allowing him to accumulate wealth in trusts while declaring little personal income, and so further investigation of these structures and gifts made to the trusts by Mr Russell was required;
- Mr Russell had a poor history of compliance; and the proposal would be an inefficient use of resources given the debt would grow faster than the payments made.

The Commissioner’s letters of 26 August 2013 and 13 September 2013 to Mr Russell were consistent with these reasons.

Decision

The application for judicial review is struck out.

Inconsistency with achieving highest net revenue

The Court held that the Commissioner could conclude it was consistent with achieving the highest net revenue if a specific offer was so small it would be better for the collection of revenue generally to reject it, even if it might offer the best possible commercial return.

An instalment arrangement would maximise recovery and was consistent with duty to recover the maximum outstanding tax

Mr Russell claimed that the Commissioner failed to comply with the duty to maximise recovery of the outstanding tax in s 177B of the Tax Administration Act 1994 (“TAA”).

The Court found the Commissioner specifically referred to and set out in full s 177B in her memorandum. Further, the decision that there was too much uncertainty to warrant a decision that acceptance of the offer would maximise recovery was entirely open to the Commissioner in these circumstances. Pushing execution may produce a better result, and the Commissioner had a duty to consider broader issues of the overall integrity of the tax system.

Costs of continuing to litigation an inefficient use of resources

Mr Russell essentially argued the grounds set out in s 177B(2) of the TAA for the Commissioner declining to enter into an instalment arrangement were not made out.

Asher J held s 177B(2) had to be seen in the broader context of the TAA. The Commissioner could form the view that there could be some recovery, and that it could be more than was offered. There were grounds to consider that it was an efficient use of resources to proceed to execute the judgment against Mr Russell by bankruptcy proceedings or other execution. Moreover, the Commissioner was of the view that the proposals would not maximise the recovery of tax from Mr Russell, as a better return might be achieved by enforcement.

Decision not reasonable or rational

The Court found Mr Russell’s complaints under this head related to the fairness of the Commissioner’s decision to seek payment of the tax due, rather than her decision on the proposal. That decision cannot be assailed in the judicial review proceeding.

Asher J stated Mr Russell should have paid the tax when it was due, and can therefore fairly be required to pay the tax now.

Failure to take into account the fact that it was the Commissioner’s decision to assess income not received by Mr Russell and which he could not recover, as a reason he could not pay tax

This was held to have been exhaustively litigated. Mr Russell had no further rights of challenge and could not raise the issue yet again in this judicial review proceeding.

The refusal to accept the instalment proposals was motivated by the improper purpose to bankrupt the applicant and other irrelevant considerations and was a decision no rational person could have made

There was no evidence that the decision to reject the proposal was influenced by any irrelevant or improper factors. The possible recovery if bankruptcy proceedings were brought compared to the amount recovered if Mr Russell’s proposed arrangement was accepted was a relevant consideration.

Disproportionally severe treatment or punishment in breach of s 9 of the New Zealand Bill of Rights Act 1990 (“NZBORA”) and an excessive fine in breach of the Bill of Rights Act 1688

It was held to be nonsensical to suggest that the Commissioner, in proceeding to bankrupt Mr Russell, was acting in a way that could be equated with torture or cruel and degrading treatment or punishment under s 9 of the NZBORA.

Article 1 of the Bill of Rights Act 1688 did not apply, as it was exclusively concerned with the conduct of Judges in enforcing the criminal law and extended only to judicially imposed punishments, of which this was not.

Asher J distinguished *W v Commissioner of Inland Revenue* (2005) 22 NZTC 19,602 (HC) and *Chesterfields Preschool Ltd v Commissioner of Inland Revenue* (2007) NZTC 21,125 (HC) on the basis that both were fact specific and involved errors by the Commissioner not present here.

Failure to give adequate or rational reasons

The letters provided to Mr Russell sufficiently set out why Mr Russell’s proposals were rejected based on the applicable statutory framework. In regards to the judicial settlement conference, nothing more than oral reasons provided at the conference could be expected.

Abuse of process

Asher J was of the view that the judicial review proceedings were an abuse of the Court’s process. There is a public interest in proceedings to enforce civil debts being allowed to proceed through the courts in a timely manner and for such proceedings not to be subjected to undue delay.

It must be in the public interest that the Commissioner is able to expeditiously carry out the duties imposed by the revenue acts including pursuing and completing enforcement action, and not be stalled by challenges to her refusal to accept minimal settlement offers.

The fact that Mr Russell waited seven years and six months before bringing a proceeding challenging the decision was indicative of an abuse of procedure. Judicial review proceedings challenging earlier decisions must be brought reasonably promptly for the judicial review application process to work efficiently and fairly. The judicial review proceedings were issued following the exhaustion by Mr Russell of his orthodox legal challenges to the Commissioner’s assessment against him. The earlier delay and the pursuit now of this proceeding were held to be indicative of this proceeding being an abuse of procedure.

The attempt in the statement of claim to challenge indirectly yet again the fact that Mr Russell was assessed is a misuse of the judicial review procedure, and an indication that the proceedings as a whole are an abuse.

The judicial review proceeding was held to have no merit.

TRA CONSIDERS IT HAS NO JURISDICTION TO CONSIDER GST PERIODS

Case	TRA 028/08; [2015] NZTRA 06
Decision date	20 April 2015
Act(s)	Goods and Services Tax Act 1985
Keywords	Objection, Goods and Services Tax, Points of Objection Notice

Summary

The Taxation Review Authority (“TRA”) held that only three goods and services tax (“GST”) periods were properly before it.

Facts

The Commissioner of Inland Revenue (“the Commissioner”) deregistered the objector for GST effective from 31 August 1995, and reassessed the objector for the three six-month periods prior to the date of deregistration.

The objector lodged objections that were determined against it in 2008, and the Points of Objection Notice was subsequently served on the Commissioner. The Points of Objection Notice was served out of time, however Judge Barber found extraordinary circumstances and granted an extension for its filing.

The objector argued that five earlier tax periods, namely income tax for 1984 to 1995 (inclusive) and GST from 1 September 1986 to 31 August 1995 (inclusive), were also before the TRA in this proceeding.

The objector contended that its notice of objection to five of the GST periods (the disputed periods) was never

disallowed. The Commissioner argued that four of the objections were made within time and disallowed in October 1986, and no request was received for a case to be stated within the requisite time period. As to the period ended 28 February 1990, the Commissioner argued this period was never reassessed and so could not be objected to.

With regards to the remaining GST and income tax periods, the objector contended these were before the TRA because the TRA had all the powers of the Commissioner in regards to assessments. The Commissioner argued the TRA only had jurisdiction where the relevant procedural provisions had been complied with, and this had not occurred.

Decision

Disputed GST periods

The TRA accepted that the Commissioner reassessed the disputed GST periods and sent the objector notices of assessment. The objector wrote to the Commissioner acknowledging receipt of a “Notice of Assessment – Statement of Account” and gave notice of objection to the reassessments. The Commissioner argued these objections were subsequently disallowed and that the manager of the Tax Avoidance Unit wrote to the director of the objector (“the Director”) on 30 October 1996 (“the Letter”) advising of this and setting out the procedure if the objector wished to pursue its objections. No request was received from the objector for a case to be stated within the statutory period.

The Director deposed that the Letter was not received by the objector. The tax agent’s evidence was that if the Letter had been received, a request would have been made for a case to be stated.

In early 2006, an Inland Revenue investigator started an investigation and on 10 April 2006 wrote to the Director advising of the status of the disputed GST periods, among other matters. The investigator later spoke with the Director, and sent a further letter dated 8 December 2006 enclosing copies of the letters of disallowance and advising that, as no case had been stated, the assessments for the disputed GST periods were confirmed and payment was overdue. No reply was received, and the investigator wrote to the Director again on 7 December 2007, enclosing a copy of the 8 December 2006 letter.

The TRA found the onus was on the objector to prove on the balance of probabilities that it did not receive the Letter. On the evidence, the TRA found on the balance of probabilities that the Letter was not received.

Despite the Commissioner having a copy of the Letter on file with a document log number assigned, there was no evidence of postage. The Commissioner could not therefore avail herself of the deemed receipt by post provision.

The TRA found there was no reason to disbelieve the Director's evidence regarding receipt of the Letter. The absence of a response by the objector to the investigator's 2006 letter denying receipt of the Letter was not of evidential value, especially given the 10-year gap. The Director's request for copies of the "letters of disallowance of objections" referred to in the letter of 10 April 2006 was consistent with the Letter not being received.

The Director's evidence that a Points of Objection Notice would have been issued if the Letter had been received was considered important, as such an approach was consistent with that taken by the objector to maintain its objection in respect of the GST deregistration and associated GST periods.

The TRA did not accept that even if the Letter was not received, notice was given in the Commissioner's later letters of 10 April 2006, 8 December 2006 and 7 December 2007, and subsequent correspondence. These letters were not held to be notification for the purposes of the relevant legislation.

However, the TRA disagreed with the objector's contention that the disputed GST periods were properly before the TRA, as the TRA had no jurisdiction where, as in this case, the objection procedure had not been properly completed.

All remaining GST periods and income tax years

The Director contended the Commissioner could and should have reassessed all the periods listed in the Points of Objection Notice before now, and that the TRA had the authority and duty to do so. Further, the Director contended the TRA had the authority to consider additional periods as the necessary procedural steps had been fulfilled "as best they can be by the objector in view of all the circumstances".

The TRA found the objection procedure had not been completed for the remaining GST periods and income tax years. As such, the objections in relation to these periods were not before the TRA and there was no jurisdiction to hear such matters.

The TRA also noted that a similar matter is currently back before the Commissioner for her reconsideration, following an order from Ellis J in the High Court. Leave was reserved in that case to bring the matter back before the High Court if progress was not made.

NOTICE OF DEFENCE NOT NECESSARY WHEN FILING AN APPLICATION TO STRIKE OUT

Case	TRA 019/14; [2015] NZTRA 03
Decision date	24 March 2015
Act(s)	Taxation Review Authorities Act 1994, Taxation Review Authorities Regulations 1998, High Court Rules 2008, District Court Rules 2014, Tax Administration Act 1994
Keywords	Protest to jurisdiction, application to strike out

Summary

This was a decision of the Taxation Review Authority ("TRA") dismissing the disputant's Notice of Appearance under Protest to Jurisdiction, finding the TRA had jurisdiction to hear the Commissioner of Inland Revenue's ("the Commissioner") strike-out application even though no Notice of Defence had been filed.

Impact

The judgment confirms that the TRA is comfortable with the practice of Notices of Defence not being filed where a strike-out application has already been made.

Facts

The disputant commenced a challenge in the TRA for his 2010 and 2011 income tax years. The Commissioner did not file a Notice of Defence but instead filed an Application to Strike out the Claim and sought an order deferring the date for filing her Notice of Defence until otherwise ordered to do so by the TRA. These matters were set down to be heard on 10 February 2015.

On the day of the hearing, the disputant filed a Notice of Appearance under Protest to Jurisdiction. The TRA asked for the Commissioner's written submission and the decision was made on the papers.

Decision

The disputant argued that the TRA regulations, being "an imperative statute", required the Commissioner to file a Notice of Defence by 24 November 2014. The Commissioner had not done so and as such, the TRA had no jurisdiction to hear the strike-out application.

The TRA dismissed the disputant's Notice of Appearance under Protest to Jurisdiction, finding that the TRA had jurisdiction to hear the Commissioner's strike-out application even though no Notice of Defence had been filed.

The TRA noted that it is well established under the High Court Rules that a party who seeks to strike out a pleading is not required to first file a Statement of Defence. The same approach is taken under the District Court Rules 2014. Although the TRA Regulations do not set out a procedure for an application to strike out a notice of claim, it is provided for under the District Court Rules 2014. The TRA found that it would not be inconsistent with the TRA Regulations if the approach prescribed by the High Court and District Court Rules was applied.

The TRA was also satisfied that it had the discretion to extend the time for filing a Notice of Defence, even when the application for the extension was not made until after the expiration of the time appointed.

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

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