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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

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

Ref	Draft type/title	Description/background information	Comment deadline
ED0182	Draft Depreciation Determination: Geothermal and Thermal Powerhouses	The Commissioner proposes to set depreciation rates for geothermal and thermal powerhouses by adding new asset classes to the "Power generation and electrical reticulation" industry category and the "Buildings and structures" asset category.	17 August 2015
ED0177	Draft Provisional Depreciation Determination: Oil/gas equipment used to evaluate, repair or stimulate existing wellbores	The Commissioner proposes to set a general depreciation rate for several items of specialised equipment used by oil and gas industry support specialists to evaluate, repair or stimulate the performance of existing wellbores.	19 August 2015
ED0172	Draft SPS: Remission of penalties and use-of-money interest	This draft standard practice statement (SPS) sets out the Commissioner's practice when granting remission of penalties and use-of-money interest.	25 September 2015
ED0173	Draft SPS: Instalment arrangements for payment of tax	This draft statement sets out the Commissioner's practice when considering applications for financial relief by an instalment arrangement.	25 September 2015
ED0174	Draft SPS: Writing off outstanding tax	This draft statement sets out the Commissioner's practice for granting financial relief by permanently writing off outstanding tax.	25 September 2015
ED0175	Draft SPS: Child support debt – Requesting an instalment arrangement	This draft statement sets out the Commissioner's practice for providing relief when the immediate payment of an overdue child support obligation is not possible.	25 September 2015
ED0176	Draft SPS: Student loans – relief from repayment obligations	This draft statement sets out the Commissioner's practice for providing relief under the Student Loan Scheme Act 2011.	25 September 2015

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The Taxation Review Authority ("TRA") found for the Commissioner of Inland Revenue on the basis there was no evidence that management services were provided and that the Q Land Trust incurred the management fees. The TRA was also satisfied the arrangement was one of tax avoidance.

Supreme Court awards indemnity costs

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This is a costs judgment following the Supreme Court's earlier decision on 2 December 2014 to dismiss three related applications for leave to appeal. The appellants in each appeal were investors in the Trinity tax avoidance scheme.

The Commissioner of Inland Revenue (and others) applied for indemnity costs. Those applications were complicated by the bankruptcy and liquidation of a number of the appellants.

The Supreme Court noted that the established position in New Zealand is that costs made after adjudication in bankruptcy in respect of proceedings which had been commenced before adjudication were not provable in bankruptcy. The Supreme Court (following a recent English authority) reversed that position and held that costs awards following adjudication can be provable as a contingent liability. The judgment is also notable for the fact that the Supreme Court took the unusual step of awarding indemnity against the appellants.

BINDING RULINGS

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

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

PUBLIC RULING BR PUB 15/10: GOODS AND SERVICES TAX – DIRECTORS' FEES

This is a reissue of BR Pub 05/13. For more information about earlier publications of this Public Ruling see the Commentary to this Ruling.

This is a Public Ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss 6(3)(b), 6(4), 6(5), 8, 20 and 57(2)(b).

The Arrangement to which this Ruling applies

The Arrangement is the engagement, occupation or employment of a person as a director (the Director) of a company (the Company). The engagement may be by direct contract between the Director and the Company. Alternatively, the Director may be engaged as a director of the Company under an agreement between the Company and:

- a third party (the Third Party);
- the Director's employer (the Employer); or
- a partnership of which the Director is a partner (the Partnership).

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

The Director contracts directly with the Company

If the Director has not accepted the office in carrying on the Director's taxable activity:

- The engagement is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because the Director did not accept the office in carrying on the Director's taxable activity.
- The Company cannot claim an input tax deduction for any directors' fees paid to the Director because GST will not be charged on the supply of the Director's services to the Company.

If the Director has accepted the office in carrying on the Director's taxable activity:

- Section 6(5) will apply and the services will be deemed to be supplied in the course or furtherance of that taxable activity. If the Director is registered, or liable to be registered, for GST, the Director will be required to account for GST on the fees received for the supply of the directorship services.
- If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the supply of the directorship services by the Director, provided that the other requirements in the Act, such as s 20(2), are satisfied.

The Director's services are contracted by the Third Party to the Company

If the Third Party contracts with the Company to provide the Director's services as a director of the Company and the Director has accepted the office, but not as part of carrying on a taxable activity:

- The Director's engagement as director of the Company is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because the Director did not accept the office in carrying on the Director's taxable activity.
- Section 6(3)(b) does not apply to the Third Party's provision of the Director's services to the Company because the Third Party is not engaged as a director of the Company. If the Third Party is registered, or liable to be registered, for GST, the Third Party will be required to account for GST charged under s 8 on the supply of the Director's services.
- If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the

supply of the Director's services by the Third Party, provided that the other requirements in the Act, such as s 20(2), are satisfied.

If the Third Party contracts with the Company to provide the Director's services to the Company and the Director accepts the office in carrying on the Director's taxable activity:

- Because the Director accepted the office in carrying on their taxable activity, under s 6(5) any directorship services provided by the Director are deemed to be supplied in the course or furtherance of the Director's taxable activity.
- In this situation, there are two relevant supplies for GST purposes. The **first supply** is the Director providing their services to the Third Party. The **second supply** is the Third Party providing the Director's services to the Company.
- For the first supply:
  - The Director is required to account for GST charged under s 8 on the supply of their services to the Third Party.
  - If the Third Party is carrying on a taxable activity and is registered for GST, the Third Party may claim a deduction for input tax under s 20(3) for the GST charged on the supply of the Director's services by the Director, provided that the other requirements in the Act, such as s 20(2), are satisfied.
- For the second supply:
  - Section 6(3)(b) does not apply to the Third Party's supply of the Director's services to the Company because the Third Party is not engaged as a director of the Company. If the Third Party is registered, or liable to be registered, for GST, the Third Party is required to account for GST charged under s 8 on the supply of the Director's services.
  - If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the supply of the Director's services by the Third Party, provided that the other requirements in the Act, such as s 20(2), are satisfied.

The Director's services (as employee) are contracted by the Employer to the Company

If the Director, as part of their employment, is engaged as a director of the Company under a contract between the Employer and the Company:

- The Director's engagement as director of the Company is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because the Director did not accept the office in carrying on the Director's taxable activity. The office was accepted as part of the Director's employment with the Employer.
- Section 6(3)(b) does not apply to the Employer's supply of the Director's services to the Company because the Employer is not engaged as a director of the Company. If the Employer is registered, or liable to be registered, for GST, the Employer will be required to account for GST charged under s 8 on the supply of the Director's services to the Company.
- If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the supply of the Director's services by the Employer, provided that the other requirements in the Act, such as s 20(2), are satisfied.

The Director's services (as employee) are contracted directly to the Company and the Director is obliged to account to their Employer for the director's fees received

The Director (employee) may be engaged by the Company to be a director of that company, where:

- the Director is required to account to their Employer for the director's fees received;
- there is no contract between the Company and the Employer; and
- the Director has not accepted the office in carrying on their own taxable activity.

In this situation:

- The Director's engagement as director of the Company is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because the Director did not accept the office in carrying on the Director's taxable activity.
- Under s 6(4), any fees paid by the Company to the Director are treated as consideration for a supply of services by the Employer to the Company. If the Employer is registered, or liable to be registered, for GST, the Employer will be required to account for GST charged under s 8 on the supply of the Director's services.
- If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the supply of the Director's services by the Employer, provided that the other requirements in the Act, such as s 20(2), are satisfied.

The Director's services (as a partner in a partnership) are contracted to the Company and the Director is obliged to account to the Partnership for the director's fees received

If the Director (as a partner in a partnership) accepts an office as a director of the Company as part of the Partnership's business:

- The Director's engagement as director of the Company is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because, although the Director may be carrying on the taxable activity of the partnership, the services are deemed to be supplied by the partnership under s 57(2)(b).
- Section s 6(3)(b) does not apply to the Partnership's provision of the Director's services to the Company because the Partnership is not engaged as a director of the Company. If the Partnership is registered, or liable to be registered, for GST, the Partnership will be required to account for GST charged under s 8 on the supply of the Director's services.
- If the Company is carrying on a taxable activity and is registered for GST, the Company may claim a deduction for input tax under s 20(3) for any GST charged on the supply of the Director's services by the Partnership, provided that the other requirements in the Act, such as s 20(2), are satisfied.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 30 June 2014.

This Ruling is signed by me on 29 June 2015.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 15/10

This Commentary is not a legally binding statement. The Commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 15/10 ("the Ruling").

Legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. Relevant legislative provisions are reproduced in Appendix 2 to this Commentary.

Summary

1. This Ruling and Commentary explains whether directors' fees are subject to GST. The Ruling and Commentary also consider whether a company engaging a director is entitled to claim input tax deductions for fees paid to that director.
2. This Ruling and Commentary sets out the GST treatment for fees paid to a director in two broad situations. The first is where the director contracts either directly with a company or through a third party. The second is where a director is either an employee of a third party or a partner in a partnership.
3. A director must charge GST on their supply of services when the following requirements are satisfied:
   - the director is registered or liable to be registered in respect of a taxable activity that they undertake; and
   - the director accepts the office in carrying on that taxable activity.
4. A director is not required to charge GST on their supply of services as a director where:
   - they are engaged as a director in their capacity as an employee of a third party employer; or
   - they are engaged in their capacity as a partner in a partnership.
5. Essentially, if a registered person accepts an office as a director in carrying on their taxable activity, the fees that person receives for providing their services will be subject to GST.
6. A flowchart that illustrates the GST treatment of directors' fees from a director's perspective can be found in Appendix 1 to this Commentary.
7. Where the director has been engaged in their capacity as an employee, they may be required to account for their fees to their employer. In this situation, the employer is deemed to make the supply of services, rather than the director. If the employer is registered, or liable to be registered, for GST, the employer will be required to account for GST on the supply of the director's services to the company.
8. Where the director has been engaged in their capacity as a partner in a partnership, the partnership is deemed to make the supply of services, rather than the director. If the partnership is registered, or liable to be registered, for GST, the partnership will be required to account for GST on the supply of the director's services.
9. From the perspective of a company that engages a director, the company may claim an input tax deduction for the fees it pays, if:
   - the company is registered; and
   - GST was charged on the directors' fees and the company holds a tax invoice for those fees.

10. Other requirements of the Act may also need to be satisfied depending on individual circumstances.

Background

11. BR Pub 15/10 sets out the Commissioner's view on the GST treatment of directors' fees. The Commentary to this Ruling explains the reasoning adopted. The previous Ruling, BR Pub 05/13, was issued on 1 April 2005 for an indefinite period. However, s 6 of the Act was amended with effect from 30 June 2014 by s 187 of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014. BR Pub 05/13 was withdrawn from 30 June 2015.

12. Two amendments were made to s 6 that relate to the GST treatment of fees paid to directors. The first amendment moved the former proviso to s 6(3)(b) to a new s 6(5). Before the amendment, the proviso to s 6(3)(b) treated services performed by directors as being supplied in the course or furtherance of a taxable activity when the director accepted the office in carrying on that taxable activity.

13. The second amendment introduced a new s 6(4). Section 6(4) provides that when an employee is engaged by a company to be a director and the employee is required to account for any fees received to their employer, the employer will be treated as supplying the services to the company. The employer will therefore return GST output tax and the company will be able to claim input tax on the payment for these services. The Ruling has been updated to reflect the new structure of s 6 and to explain the effect of s 6(4).

14. The previous Ruling and Commentary (BR Pub 05/13) replaced BR Pub 00/11 from 1 April 2005 for an indefinite period (see *Tax Information Bulletin* Vol 17, No 7 (September 2005): 9). BR Pub 00/11 applied for the period 26 October 2000 to 31 March 2005 (see *Tax Information Bulletin* Vol 12, No 11 (November 2000): 3). BR Pub 00/11 replaced BR Pub 00/09, which contained an application period that was seen to be retrospective. BR Pub 00/09 was published in *Tax Information Bulletin* Vol 12, No 9 (September 2000): 9, to replace the policy items on "GST on Directors' Fees" contained in *Public Information Bulletins* 164 and 175.

Summary of the Legislation

15. This part of the Commentary summarises the legislation relevant to two issues:

- whether directors' fees are subject to GST; and
- whether a company is entitled to claim input tax deductions for fees paid to a director who is also an employee of a third party employer.

Scheme of the GST Act

16. Section 8(1) provides that GST is charged on the supply (but not an exempt supply) in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person. GST is regarded as a transactions tax because it is imposed on supplies of goods and services. On this basis, it is the contractual relationship between the parties (founded on a genuine basis) that determines the GST treatment of the relevant transactions (*Wilson & Horton v CIR* (1995) 17 NZTC 12,325 (CA)).

17. GST is imposed on supplies made by registered persons. A "registered person" is a person that is registered, or liable to be registered, for GST. A person may be liable to be registered for GST if the value of their total supplies in New Zealand in a 12-month period exceeds the threshold amount in s 51. However, to be liable to account for GST, a registered person must carry on a "taxable activity".

Requirements of a "taxable activity"

18. Section 6 defines the term "taxable activity" for the purposes of the Act. Section 6(1) defines a "taxable activity" as an activity that is carried on continuously or regularly, and involves, or is intended to involve, the supply of goods and services to another person for a consideration. Therefore, a person conducts a taxable activity when all of the following characteristics are present:

- There is some form of activity.
- The activity is carried on continuously or regularly.
- The activity involves, or is intended to involve, the supply of goods and services to another person for a consideration.

19. The section also includes within the term "taxable activity" the activities of any public or local authority.

20. Under s 6(2) anything done in connection with the commencement or termination of a taxable activity is deemed to be carried out in the course or furtherance of that taxable activity.

21. Section 6(3) provides certain exclusions from the term "taxable activity". Relevantly, for the purposes of this Ruling and Commentary, any engagement, occupation or employment of a person as a director is excluded from the definition of "taxable activity": s 6(3)(b).

22. However, in certain circumstances, a director can be deemed to provide their services as part of a taxable activity under s 6(5). Section 6(5) applies where a person, in carrying on a taxable activity, accepts an office as director. Section 6(5) applies to persons appointed as a director under s 6(3)(b). In this

situation, any services provided by the director are deemed to be supplied in the course or furtherance of the director's taxable activity. Therefore, if a GST-registered sole trader accepts a directorship in carrying on their taxable activity, s 6(5) applies and the sole trader is liable to return GST on any director's fees received.

Deemed supplies by employers

23. A company may engage a person as director who is an employee of a third party employer. An employer may agree to an employee being engaged as a director of a company on the condition that the employee accounts to the employer for any directors' fees received. In this situation, the company would ordinarily be precluded from claiming any GST input tax deductions on director's fees paid to the employee of a third party employer. The reason for this is that, generally, the employee would not be carrying on a taxable activity. This is because the term "taxable activity" excludes any engagement, occupation or employment under any contract of service: s 6(3)(b).

24. Section 6(4) was introduced to allow a company to claim input tax deductions for fees paid to a director who is an employee of a third party employer. Section 6(4) provides that when an employee of a third party employer is engaged by a company to be a director and the employee is required to account for any fees received to their employer, the employer is deemed to supply the services to the company. The employer will therefore be liable for GST output tax on the supply of the services and the company will be able to claim input tax on the payment for those services. For more information on the introduction of this subsection, see *Tax Information Bulletin*, Vol 26, No 7 (August 2014): 96.

Application of the legislation

25. This Ruling considers the GST treatment of the supply of services as a director. The following analysis explains the GST treatment of supplies of services provided by a director in the following circumstances:

- a person (with or without a taxable activity) is engaged in their personal capacity as a director of a company;
- a person (with or without a taxable activity) is contracted as a director of a company by a third party;
- an employee of a third party employer is engaged as a director of a company; and
- a partner in a partnership is engaged as a director of a company.

Director engaged in their personal capacity

26. A person may accept an office as a director in their personal capacity and not as part of carrying on any taxable activity. Alternatively, a person may accept an office as a director as part of carrying on that person's taxable activity.

27. If the person accepts an office in their personal capacity and not as part of carrying on a taxable activity, then the activity of supplying services as a director falls within the exclusion in s 6(3)(b). Section 6(5) does not apply because the person has not accepted the office as part of carrying on a taxable activity.

28. However, if the director has accepted the office as part of carrying on a taxable activity, s 6(5) overrides the exclusion in s 6(3)(b) and deems the services to be supplied in the course or furtherance of that taxable activity. If the director is registered, or liable to be registered, for GST, the director will be required to account for GST output tax on the fees received for the services they supply.

Example 1: Director engaged in their personal capacity and does not have taxable activity

Claudius, who is not registered for GST, is an employee of a marketing agency. Fortinbras Ltd engages Claudius as a director and pays him fees for his services. Claudius' appointment as a director is not connected with his employment, nor has he accepted the directorship as part of carrying on a taxable activity. He retains the fees, having received them in his personal capacity.

Claudius is engaged as a director of a company, an activity that is excluded from the term "taxable activity" by s 6(3)(b). Section 6(5) does not apply, because Claudius did not accept the directorship as part of carrying on a taxable activity. Claudius is not required to account for GST on the fees received for directorship services.

Fortinbras Ltd cannot claim input tax deductions on the fees paid to Claudius because no GST was charged on those fees.

Example 2: Director engaged in their personal capacity and has a taxable activity

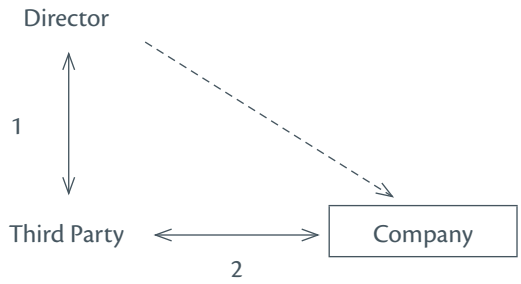
Ophelia is a human resources consultant in business on her own. She is registered for GST. Ophelia accepts

a position as a director of Reynaldo Ltd as part of carrying on her taxable activity. She receives fees for her services.

Because Ophelia has accepted the directorship as part of carrying on her taxable activity, s 6(5) deems her services to be supplied in the course or furtherance of her taxable activity. Ophelia should therefore provide Reynaldo Ltd with a tax invoice and account for GST output tax on the fees she is paid.

Reynaldo Ltd may claim input tax deductions for the fees paid to Ophelia, provided the requirements of the Act, such as s 20(2), are met.

Director contracted to company by third party



29. A third party may agree to provide the services of a director to a company. In this situation there are two relevant supplies for GST purposes. The first supply is the director providing their services to the third party. The second supply is the third party providing the director's services to the company.
30. The director may accept the office in the course or furtherance of a taxable activity. If the office is not accepted in the course or furtherance of a taxable activity, the director's engagement is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) would not apply because the director's services are not supplied as part of carrying on a taxable activity. Therefore, there can be no supply for GST purposes between the director and the third party.
31. However, if the director accepts the office in carrying on a taxable activity, s 6(5) deems the director's services to be supplied in the course or furtherance of their taxable activity. This is the first supply. In this situation, the director will invoice the third party for providing the director's services. The director will therefore be required to account for GST output tax on the fees they receive for these services.
32. In relation to the second supply, the third party invoices the company for the third party's services in providing the director's services. If the third party is registered, or liable to be registered, for GST, they will be required to account for GST output tax on the fees received for the supply of the director's services. Section 6(3)(b) will not apply because the third party is not engaged as a director of a company.

Example 3: Director contracted to company by third party and does not have taxable activity

A GST-registered financial management company, Polonius Ltd, agrees to supply Osric Ltd with the services of a director. Polonius Ltd supplies the services of Marcellus, one of its specialist employees, to Osric Ltd. Directors' fees are paid by Osric Ltd to Polonius Ltd for the services provided by Marcellus.

The engagement of Marcellus as a director is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply as Marcellus has not accepted the office as part of carrying on a taxable activity. Marcellus has accepted the office as part of his employment with Polonius Ltd. Therefore, Marcellus is not required to account for GST on the supply of his directorship services.

Section 6(3)(b) does not apply to the activity of Polonius Ltd because that company is not engaged as a company director. The fees are paid in consideration of Polonius Ltd providing the services of Marcellus to Osric Ltd. This is a supply in the course or furtherance of Polonius Ltd's taxable activity and that company will be required to account for GST output tax on the fees received for this supply.

If Osric Ltd is registered for GST, it may claim input tax deductions for the fees paid to Polonius Ltd, provided the requirements of the Act, such as s 20(2), are met.

Example 4: Director contracted to company by third party and has taxable activity

Horatio is a GST-registered accountant in business on his own. A consulting firm, Voltimand Ltd, agrees to supply another company, Yorick Ltd, with the services of a director to monitor Yorick Ltd's financial systems. Horatio agrees with Voltimand Ltd to provide his services as a director of Yorick Ltd. There are two supplies involved in this arrangement. First, Horatio provides his services to Voltimand Ltd. Second, Voltimand Ltd supplies the services of Horatio to Yorick Ltd.

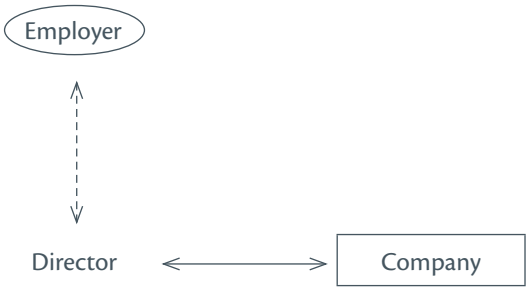
Horatio's engagement as a director of Yorick Ltd is excluded from the term "taxable activity" under s 6(3)(b). However, as Horatio has accepted the office as part of carrying on his taxable activity as an accountant, s 6(5)

deems his services as a director to be supplied in the course or furtherance of his taxable activity. In relation to the first supply, Horatio will therefore be required to account for GST output tax on the fees he receives from Voltimand Ltd for these services.

In relation to the second supply, Voltimand Ltd's supply of Horatio's services to Yorick Ltd does not fall within s 6(3)(b) because Voltimand Ltd is not engaged as a director of a company. Provided Voltimand Ltd is registered, or liable to be registered, for GST, it will be required to account for GST output tax on the fees received for the supply of Horatio's services.

If Yorick Ltd is registered for GST, it may claim input tax deductions for the fees paid to Voltimand Ltd, provided the requirements of the Act, such as s 20(2), are met.

Employee engaged as a director

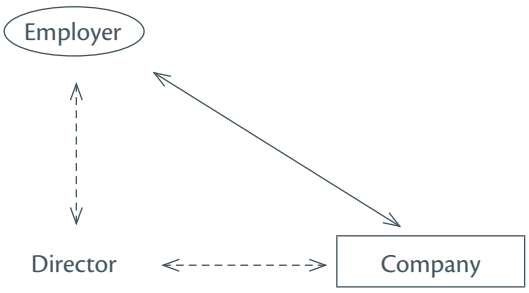


33. A company may engage a person as director who is also an employee of a third party employer. In this situation, either the employee holds the office as part of their employment duties, or the employee holds the office outside of their employment. In this type of scenario, there is no contract between the employer and the company.

34. If the employee holds the office outside of their employment, they will be a director in their personal capacity (see Examples 1 and 2 above). Because the director is also an employee, it is unlikely that they will have a taxable activity, but this will depend on the circumstances of each case.

35. Sometimes an employer will permit an employee to accept an office, provided the employee accounts to the employer for the fees received. If the employee holds the office as part of their employment, the engagement of the employee as a director is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply as the director has not accepted the office as part of carrying on a taxable activity—the director is merely carrying out his or her employment duties.

36. Section 6(4) provides that when an employee is engaged as a director of a company and the employee is required to account for any fees received to their employer, the employer will be treated as supplying services to the company. This is illustrated by the following diagram:



37. The employer (provided it is registered, or liable to be registered, for GST) will therefore return GST output tax on the supply of the services by the employee and provide a tax invoice to the company. The company will then be able to claim input tax on the payment for these services.

Example 5: Employee engaged as a director

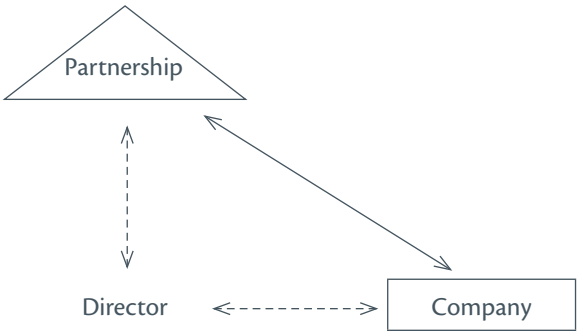
Guildenstern Ltd agrees to one of its employees, Laertes, taking up a directorship with Cornelius Ltd on the proviso that Laertes accounts for the fees he receives to Guildenstern Ltd. There is no contract between Guildenstern Ltd and Cornelius Ltd. Cornelius Ltd is not GST-registered.

The engagement of Laertes as a director is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply as Laertes has not accepted the office as part of carrying on a taxable activity. Therefore, Laertes is not required to account for GST on the supply of the directorship services.

Guildenstern Ltd is treated as making the supply of directorship services under s 6(4). If Guildenstern Ltd is registered, or liable to be registered, for GST, it is required to account for GST on the supply of the services.

Cornelius Ltd cannot claim any input tax deductions on the directors' fees it pays, because it is not GST-registered.

Partner in a partnership engaged as a director



38. A partner in a partnership may be engaged as a director of a company as part of the partnership's business.

39. Section 2(1) defines "unincorporated body" to include a partnership. Section 57(2)(b) provides that where an unincorporated body carries on a taxable activity, any supply of goods and services made as part of carrying on that taxable activity is deemed to be supplied by the unincorporated body. If the unincorporated body is a partnership, any supply of goods and services made as part of carrying on its taxable activity is deemed to be supplied by the partnership and not by any of the partners.

40. The engagement of the partner as a director is excluded from the term "taxable activity" under s 6(3)(b). Section 6(5) does not apply because, although the partner may be carrying on the taxable activity of the partnership, the services are deemed to be supplied by the partnership, and not the partner, under s 57(2)(b). Therefore, the partner is not required to account for GST on the supply of their services.

41. Section 6(3)(b) does not apply in the case of the partnership as the partnership is not engaged as a director. The partnership supplies the services of one of its partners to another person as part of its taxable activity. The partnership will therefore be required to account for GST on the fees received for the supply of the partner's services as a director. The partnership should also provide the company with a tax invoice.

42. While s 6(4) does not apply in this situation, the company will still be able to claim input tax on the payment for the director's services. This is because the partnership is deemed to supply the partner's services under s 57(2)(b) in much the same way as s 6(4) deems an employer to provide an employee's services as a director to a company.

Example 6: Partner in a partnership engaged as director of company

A GST-registered legal partnership provides legal advice to Rosencrantz Ltd. A partner in the partnership, Gertrude, is elected on to the board of directors of Rosencrantz Ltd as a representative of the partnership. Rosencrantz Ltd is GST registered.

The engagement of Gertrude as a director of a company falls within s 6(3)(b) and is therefore excluded from the term "taxable activity". Section 6(5) does not apply as, although Gertrude may be providing the directorship services, the services are deemed to be supplied by the partnership under s 57(2)(b). Therefore, Gertrude is not required to account for GST on the supply of the directorship services.

The provisions of s 6(3)(b) do not apply to the partnership as it is not engaged as a director of a company. The partnership will therefore be required to account for GST output tax on the fees it receives from the company.

Rosencrantz Ltd may claim an input tax deduction on Gertrude's directorship services that the partnership invoices it for, provided the requirements of the Act, such as s 20(2), are met.

When the company may claim an input tax deduction for fees it pays

43. A person can accept an office of director in different capacities. Depending on the capacity in which the director accepted the office, the company may receive a tax invoice from the director, the director's employer, the director's partnership, or a third party. It is not up to the company to determine the capacity in which the director accepted the office.

44. Section 6(4) applies where a director of a company is also employed by a third party employer and the director must account for their fees to that employer. In this situation, s 6(4) deems the supply of directorship services to have been made by the director's employer. If the director's employer is registered for GST, they will be able to provide a tax invoice to the company for the supply of directorship services.

45. Essentially, the company may claim an input tax deduction for the fees it pays if:

- the company is registered; and
- the company holds a tax invoice for the directors' fees.

46. Other requirements of the Act may also need to be satisfied depending on individual circumstances.

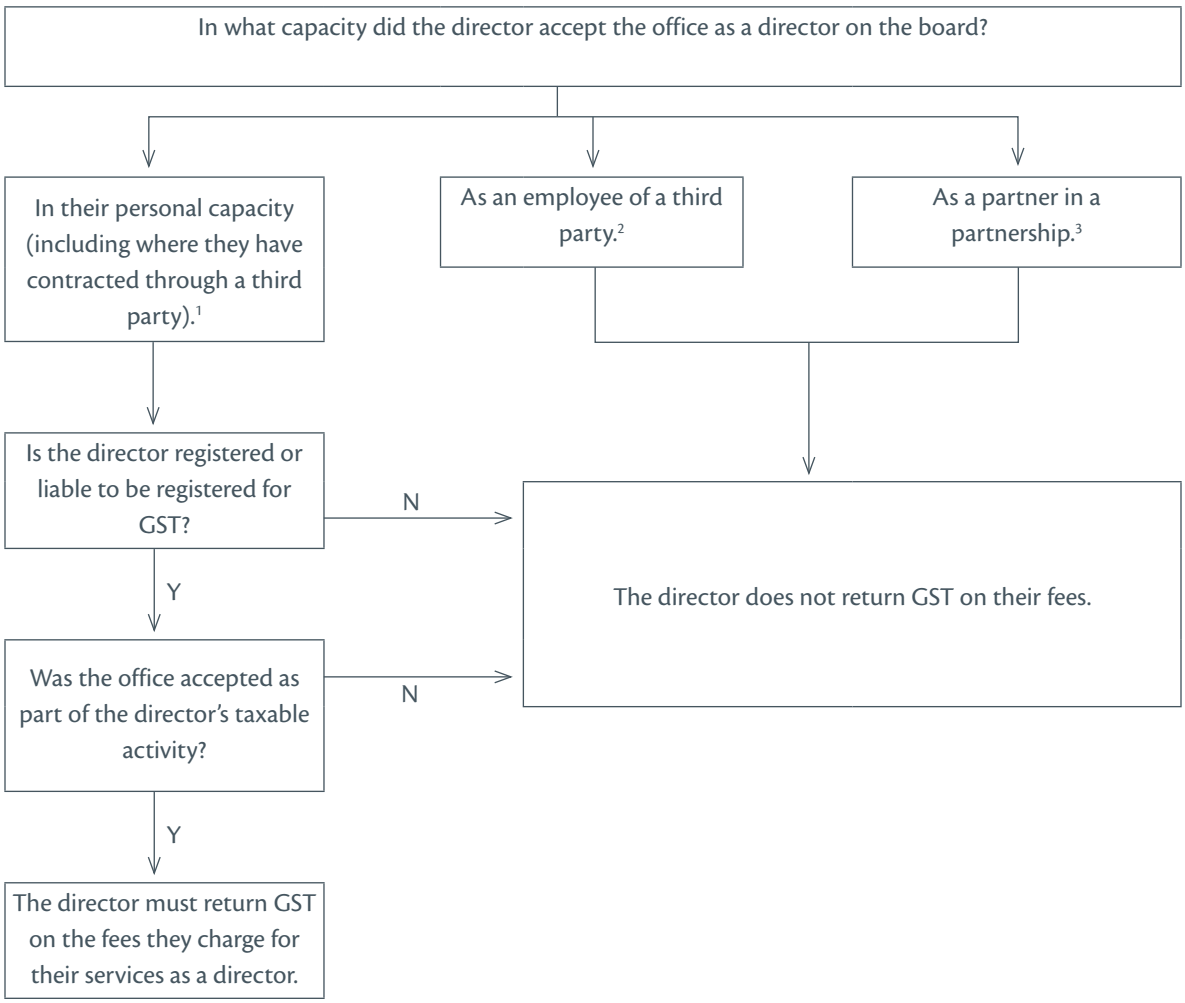
Application date

47. This Ruling applies from 30 June 2014. This is the date that the changes to s 6 came into force. The previous Ruling, BR Pub 05/13, was issued on 1 April 2005 for an indefinite period. BR Pub 05/13 is withdrawn from 30 June 2015. As a result, there is a period from 30 June 2014 to 30 June 2015 where this Ruling and the parts of BR Pub 05/13 that were not superseded by the changes to s 6 will apply at the same time. In this regard, the Rulings are consistent. The Commissioner has set the application date for this Ruling as 30 June 2014 to provide certainty for taxpayers in relation to the new legislation and because the Commissioner's view has not changed.

References

Expired Rulings
BR Pub 00/09 "Directors' Fees and GST" *Tax Information Bulletin* Vol 12, No 9 (September 2000): 9
BR Pub 00/11 "Directors' Fees and GST" *Tax Information Bulletin* Vol 12, No 11 (November 2000): 3
BR Pub 05/13 "Directors' Fees and GST" *Tax Information Bulletin* Vol 17, No 7 (September 2005): 9
Subject references
Directors' fees; GST; Output tax; Partnership; Taxable activity
Legislative references
Goods and Services Tax Act 1985 – ss 6, 8, 20, 57
Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 – s 187
Case references
Wilson & Horton v CIR (1995) 17 NZTC 12,325 (CA)
Other references
Public Information Bulletin 164
Public Information Bulletin 175
Tax Information Bulletin Vol 26, No 7 (August 2014): 96

APPENDIX 1: DOES A DIRECTOR NEED TO RETURN GST ON THEIR FEES?



[1] Where the director is contracted through a third party, the third party may need to return GST on the fees they receive for providing the services of the director to the company. See paras 29–32 of the Commentary.

[2] The employer may be required to return GST on the directors' fees where the director must account for their fees to their employer. See paras 33–37 of the Commentary.

[3] The partnership may be required to return GST on the directors' fees in this situation. See paras 38–42 of the Commentary.

APPENDIX 2: LEGISLATION

Goods and Services Tax Act 1985

1. Section 6 provides:

6 Meaning of term taxable activity

(1) For the purposes of this Act, the term taxable activity means—

(a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:

(b) without limiting the generality of paragraph (a), the activities of any public authority or any local authority.

(2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.

(3) Notwithstanding anything in subsections (1) and (2), for the purposes of this Act the term taxable activity shall not include, in relation to any person,—

(a) being a natural person, any activity carried on essentially as a private recreational pursuit or hobby; or

(aa) not being a natural person, any activity which, if it were carried on by a natural person, would be carried on essentially as a private recreational pursuit or hobby; or

(b) any engagement, occupation, or employment under any contract of service or as a director of a company, subject to subsection (4); or:

(c) any engagement, occupation, or employment—

(i) pursuant to the Members of Parliament (Remuneration and Services) Act 2013 or the Governor-General Act 2010:

(ii) as a Judge, Solicitor-General, Controller and Auditor-General, or Ombudsman:

(iia) pursuant to an appointment made by the Governor-General or the Governor-General in Council and evidenced by a warrant or by an Order in Council or by a notice published in the Gazette in accordance with section 2(2) of the Official Appointments and Documents Act 1919:

(iii) as a Chairman or member of any local authority or any statutory board, council, committee, or other body, subject to subsection (4); or

(d) any activity to the extent to which the activity involves the making of exempt supplies.

(4) Despite subsection (3)(b) and (c)(iii), if a director, member, or other person referred to in those paragraphs is paid a fee or another amount in relation to their engagement, occupation, or employment in circumstances in which they are required to account for the payment to their employer, the payment is treated as consideration for a supply of services by the employer to the person who made the payment to the director, member, or other person.

(5) For the purposes of subsections (3)(b), (c)(iii), and (4), if a person in carrying on a taxable activity, accepts an office, any services supplied by that person as holder of that office are deemed to be supplied in the course or furtherance of that taxable activity.

2. Section 8 relevantly provides:

8 Imposition of goods and services tax on supply

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

(2) For the purposes of this Act, goods and services shall be deemed to be supplied in New Zealand if the supplier is resident in New Zealand, and shall be deemed to be supplied outside New Zealand if the supplier is a non-resident.

...

3. Sections 20(1), (2), (3)(a) and (b) provide:

20 Calculation of tax payable

(1) In respect of each taxable period every registered person shall calculate the amount of tax payable by that registered person in accordance with the provisions of this section.

(2) Notwithstanding any other provision in this Act, no deduction of input tax and no deduction calculated under section 25(2)(b) or (5) shall be made in respect of a supply, unless—

(a) a tax invoice or debit note or credit note, in relation to that supply, has been provided in accordance with sections 24, 24BA, and 25 and is held by the registered person making that deduction at the time that any return in respect of that supply is furnished; or

(b) a tax invoice is not required to be issued pursuant to section 24(5) or section 24(6), or a debit note or credit note is not required to be issued pursuant to section 25; or

(c) sufficient records are maintained as required pursuant to section 24(7) where the supply is a supply of secondhand goods to which that section relates; or

(d) the supply is a supply of services that is treated by section 5B as being made by the recipient and the recipient has accounted for the output tax charged in respect of the supply; or

(e) the supply is a supply of goods and services that is treated as made under section 60B to a nominated person and that person maintains sufficient records as required by section 24(7B):

provided that where a tax invoice or debit note or credit note in relation to that supply has been provided in accordance with this Act, the Commissioner may determine that no deduction for input tax in relation to that supply shall be made unless that tax invoice or debit note or credit note is retained in accordance with the provisions of section 75.

(3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period—

(a) in the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19, the amount of the following:

(i) input tax in relation to the supply of goods and services (not being a supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies), made to that registered person during that taxable period:

(ia) input tax in relation to the supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies, to the extent that a payment in respect of that supply has been made during that taxable period:

(ii) input tax invoiced or paid, whichever is the earlier, pursuant to section 12 during that taxable period:

(iii) any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b); and

(b) in the case of a registered person who is required to account for tax payable on a payments basis or a hybrid basis pursuant to section 19, the amount of the following:

(i) input tax in relation to the supply of goods and services made to that registered person, being a supply of goods and services which is deemed to take place pursuant to section 9(1) or section 9(3)(a) or section 9(3)(aa) or section 9(6), to the extent that a payment in respect of that supply has been made during the taxable period:

(ii) input tax paid pursuant to section 12 during that taxable period:

(iii) input tax in relation to the supply of goods and services made during that taxable period to that registered person, not being a supply of goods and services to which subparagraph (i) applies:

(iv) any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b), to the extent that a payment has been made in respect of that amount; and

4. Section 57(2) provides:

57 Unincorporated bodies

(2) Where an unincorporated body that carries on any taxable activity is registered pursuant to this Act,—

(a) the members of that body shall not themselves be registered or liable to be registered under this Act in relation to the carrying on of that taxable activity; and

(b) any supply of goods and services made in the course of carrying on that taxable activity shall be deemed for the purposes of this Act to be supplied by that body, and shall be deemed not to be made by any member of that body; and

(c) any supply of goods and services to, or acquisition of goods by, any member of that body acting in the capacity as a member of that body and in the course of carrying on that taxable activity, not being a supply to which paragraph (b) applies, shall be deemed for the purposes of this Act to be supplied to or acquired by that body, and shall be deemed not to be supplied to or acquired by that member; and

(d) that registration shall be in the name of the body, or where that body is the trustees of a trust, in the name of the trust; and

(e) subject to subsections (3) to (3B), any change of members of that body shall have no effect for the purposes of this Act.

5. The term "unincorporated body" is defined in s 2 as follows:

unincorporated body means an unincorporated body of persons, including a partnership, a joint venture, and the trustees of a trust.

NEW LEGISLATION

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

ORDER IN COUNCIL

INCOME TAX (MAXIMUM POOLING VALUE) ORDER 2015

Under the pooling method of depreciation, taxpayers can group assets together and depreciate them as if they were a single asset.

Depreciation for assets in the pool is calculated based on a single rate. The rate must be the lowest depreciation rate that applies to any asset in the pool. Each asset must be worth less than the maximum pooling value, which was $2,000.

The Income Tax (Maximum Pooling Value) Order 2015, made on 2 June 2015, increased the maximum pooling value from $2,000 to $5,000, and applies to depreciation calculations made for the 2015–16 tax year.

The increase came into force on 1 July 2015.

Income Tax (Maximum Pooling Value) Order 2015 (LI 2015/141)

KIWISAVER (HOMESTART) AMENDMENT ACT 2015

The Social Housing Reform (Flexible Purchasing and Remedial Matters) Bill was one of several bills introduced under Budget urgency on 21 May 2015.

The bill was divided into four separate bills, which included the KiwiSaver (HomeStart) Amendment Bill, by the committee of the whole House on the same day. The KiwiSaver (HomeStart) Amendment Bill passed through all stages and received Royal assent on 27 May 2015. The new Act amends the KiwiSaver Act 2006.

The new legislation allows members of complying superannuation funds transferring to KiwiSaver to count their previous period of membership towards the three-year eligibility period for a first home withdrawal under the KiwiSaver rules.

COMPLYING SUPERANNUATION FUND MEMBERSHIP

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

Before 1 April 2015 the KiwiSaver withdrawal rules for the purchase of a first home included an eligibility period of at least three years in one or more KiwiSaver schemes.

The Taxation (KiwiSaver HomeStart and Remedial Matters) Act 2015 extended those rules 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.

Key features

The new legislation allows any previous period of membership in a complying superannuation fund to count towards the three-year eligibility period when a member transfers to KiwiSaver. For example, a member who had been in a complying superannuation scheme for two years would only need to be a KiwiSaver member for one additional year before satisfying the three-year eligibility period.

Application date

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

KIWISAVER BUDGET MEASURES ACT 2015

The KiwiSaver Budget Measures Bill was introduced under urgency on 21 May 2015, passing through all stages that same day. It received Royal assent on 27 May 2015, bringing into force the repeal of the Crown's $1,000 one-off kick-start payment to new enrolments as announced in Budget 2015.

The Act amends the KiwiSaver Act 2006.

REPEAL OF THE KIWISAVER KICK-START PAYMENT

Sections 223(4), 226(1), 226(3), 226(1B), 226(1C), 240 and Schedule 1 of the KiwiSaver Act 2006

As part of Budget 2015, the $1,000 Crown contribution paid to all new KiwiSaver members (the kick-start) was repealed, effective from 2 pm on 21 May.

Background

One objective of KiwiSaver is to boost the retirement savings of individuals who would otherwise not be in a position to enjoy standards of living in retirement similar to those in pre-retirement.

The KiwiSaver Act 2006 includes several subsidies to encourage additional savings but these subsidies are poorly targeted as the scheme is open to all New Zealand residents. Furthermore, there is evidence to suggest that members have simply shifted savings from one product to KiwiSaver, rather than made additional savings as a result of the subsidies. Removing the kick-start for new enrolments in KiwiSaver is intended to reduce the cost of the scheme and improve its value for money.

Key features

The main features of the new rules are as follows.

The kick-start is repealed from 2 pm on 21 May 2015.

The requirement for providers to retain the kick-start when a member makes an early withdrawal for a first home has been replaced with a requirement to retain $1,000 in the member's account so that it remains open.

Commissioner's discretion

The Commissioner has discretion to determine when the three-month wait-period for paying the $1,000 KiwiSaver kick-start contribution begins.[1] Whether this date is before or after the repeal of the kick-start determines eligibility.

Individuals can join KiwiSaver by:

- being automatically enrolled when they start employment or opting in at any time via their employer *(employer enrolments)*; or
- opting-in via their KiwiSaver provider *(provider enrolment)*.

Before enactment of the KiwiSaver Budget Measures Bill, enrolment under the KiwiSaver Act 2006 took effect on the earliest of the date the Commissioner received a person's first contribution or the date the Commissioner was notified or otherwise knew that the person had become a member of KiwiSaver.

In practice, this meant enrolment under the employment methods took effect when Inland Revenue received an enrolled person's first KiwiSaver deductions, and enrolment via a provider occurred when the individual's account was opened. Inland Revenue was required to pay the kick-start contribution as soon as practicable, three months after the person became a KiwiSaver member.

Under the new rules, eligibility for the kick-start turns on whether an individual was enrolled by 2 pm on 21 May. However, there can be some uncertainty around the exact time and date when an individual has enrolled. To ensure everyone who is entitled to the kick-start receives it, the KiwiSaver Budget Measures Act provides the Commissioner with discretion to determine when the three-month wait-period for paying out the kick-start began.

As KiwiSaver, income tax and all other deductions made from an employee's pay are processed monthly via an Employer Monthly Schedule, section 226 has been amended, effective from 1 May, to ensure that the Commissioner's discretion applies to anyone who incurred their first KiwiSaver deductions in May.

Non-compliance with financial markets legislation

Under new section 240, KiwiSaver providers are not at risk of being in breach of securities law or the Fair Trading Act 1986 in relation to documents that had already been issued.

Prospectuses and investment statements issued by providers under the Securities Act 1978 will not have to reflect the changes made in the KiwiSaver Budget Measures Act 2015 if they were issued before 22 July 2015.

[1] The kick-start is not paid in the first three months to allow a member to choose to opt-out if they have been automatically enrolled, or to select a KiwiSaver scheme before the Commissioner allocates them to a default provider.

Product disclosure statements issued under the Financial Markets Conduct Act 2013 will not have to be updated to reflect the changes made in the KiwiSaver Budget Measures Act 2015 until 22 July 2015.

Non-compliance with the Fair Trading Act 1986 is ignored to the extent that the non-compliance results from changes made in the KiwiSaver Budget Measures Act 2015 and does not continue on or after 22 July 2015. This ensures that advertisements that may refer to the kick-start are not immediately in breach of the Fair Trading Act 1986 after the kick-start's repeal.

Application dates

The new Commissioner's discretion came into force on 1 May 2015. The remaining changes came into force at 2 pm on 21 May 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.

GENERAL DEPRECIATION DETERMINATION DEP93: PORTABLE FENCES (GALVANISED STEEL)

Note to Determination DEP93

The Commissioner sets general depreciation rates for "Portable fencing (galvanised steel)". New asset classes are added into the "Contractors, builders and quarrying" industry category and "Hire equipment" asset category, as set out below.

Portable fencing that is available for short-term hire (one month or less) will also fall within the asset class of "Contractors, building and quarrying equipment for hire with a general DV rate based on an estimated useful life of 8 years" in the "Hire equipment (short-term hire of one month or less only)" asset category.

Portable fencing is short-term, easily movable fencing consisting of lightweight panels, weighted feet and clamps. It is easy to store, transport, erect and remove.

Portable fencing generally has an estimated useful life of 8 years. However, portable fencing that is hired out to be used by others has an estimated useful life of 5 years.

DETERMINATION DEP93: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 93

1. Application

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

This determination applies from the 2015 and subsequent income years. Taxpayers who have filed their income tax return prior to this determination being issued may request amended assessments pursuant to section 113 of the Tax Administration Act 1994.

2. Determination

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

- adding into the "Contractors, builders and quarrying" industry category, a new asset class with the estimated useful life and diminishing value and straight line depreciation rates as listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Portable fencing (galvanised steel)	8	25	17.5

- adding into the "Hire equipment" asset category, a new asset class with the estimated useful life and diminishing value and straight line depreciation rates as listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Portable fencing (galvanised steel)	5	40	30

3. Interpretation

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

This determination is signed on the 9th day of July 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.

SUPREME COURT DENIES LEAVE TO APPEAL TRANSFER CASE

Case	Kensington Developments Limited (In Receivership) v Commissioner of Inland Revenue
Decision date	4 June 2015
Act(s)	Tax Administration Act 1994, Supreme Court Act 2003
Keywords	Section 138N(2), s 13(2), general or public importance, *Erris*, general commercial significance, transfer

Summary

The Supreme Court dismissed Kensington Developments Limited (In Receivership)'s application for leave to appeal the Court of Appeal's decision, granting a transfer of the challenge proceeding filed in the Taxation Review Authority ("TRA") to the High Court.

Facts

The Commissioner of Inland Revenue ("the Commissioner") applied to the High Court to transfer a challenge commenced by the applicant in the TRA to the High Court.

The applicant, a company controlled by Mr J G Russell, opposed the transfer application. The High Court and the Court of Appeal both ruled in favour of the Commissioner.

The applicant sought leave to appeal to the Supreme Court, advancing cost-related grounds for not allowing the transfer to the High Court where Mr Russell, being a non-lawyer, would not be able to represent the disputant company.

Decision

The Supreme Court dismissed the leave application as the statutory criteria for appeal had not been made out.

The considerations raised by the applicant on the interlocutory issue of the transfer had been fully considered by both the High Court and the Court of Appeal.

TAXPAYER ONLY ABLE TO CHALLENGE WHETHER COMMISSIONER'S OPINION THAT RETURN IS FRAUDULENT OR WILFULLY MISLEADING WAS HONESTLY HELD

Case	TRA010/14 [2015] NZTRA 09
Decision date	8 June 2015
Act(s)	Tax Administration Act 1994
Keywords	Time bar, fraudulent or wilfully misleading, honestly held opinion

Summary

The Taxpayers filed returns claiming deductions for payments described as being insurance payments to a captive insurance company. They subsequently accepted that they were not entitled to the deductions and sought to reverse the "insurance payments" in later years, not in the years the deductions were claimed. The Commissioner of Inland Revenue ("the Commissioner") formed the opinion that the original returns were fraudulent or wilfully misleading and, accordingly, she was not time-barred from reassessing the years when the deductions were claimed. The Commissioner also assessed evasion shortfall penalties. The taxpayers unsuccessfully challenged the time-bar issue but successfully challenged the evasion shortfall penalty.

Impact

The impacts of the decision are as follows:

1. A taxpayer cannot challenge the correctness of the Commissioner's opinion formed under s 108(2) of the Tax Administration Act 1994 ("TAA") that a return is fraudulent or wilfully misleading and the Hearing Authority may not substitute its own opinion for that of the Commissioner.

2. A taxpayer may only challenge whether, objectively, the Commissioner honestly held the opinion that the return was fraudulent or wilfully misleading.
3. Knowledge and intention that the tax returns are wrong, or being reckless as to whether or not the returns are wrong, can be sufficient to meet the fraudulent or wilfully misleading test in s 108(2) of the TAA.

Facts

The first disputant, Mr AB, is a farmer and businessman. During the relevant period, Mr AB together with his two brothers, held shares in the second disputant, XY Construction Limited ("XYCL"). XYCL was in the business of construction and mining.

The three brothers were also, during the relevant period, in a farming partnership ("XY Partnership").

Sometime in 2004, Mr AB became interested in setting up a self-insurance scheme to provide cover to XY Partnership and XYCL as he was concerned about the increasing cost of insurance they were paying.

Mr AB discussed his proposal with his accountants ("ZK Accountants") who in turn obtained specialist tax advice on the issue.

The tax advice was that, provided the Captive Insurance Company is a genuine general insurance company and in fact can show that it is bearing genuine insurance risk itself, the insurance premium should be deductible. The tax advice also included that the Captive Insurance Company would need to comply with general insurance practices, including the payment of a $500,000 insurance bond to the Insurance Authorities.

An Australian company, CQ Construction Pty Ltd ("CQ Construction"), which was controlled by the brothers, was intended to serve as the Captive Insurance Company.

CQ Construction was not, however, in a position to pay the required $500,000 insurance bond.

It was decided that XY Partnership and XYCL were to immediately start paying premiums by way of promissory notes to the intended Captive Insurance Company (insurance payments) and to register CQ Construction as an insurer once XY Partnership and XYCL were in a position to pay the insurance bond. Mr AB also gave evidence of his intention to change the company name of CQ Construction to CQ Insurers Pty Ltd, although he never got around to doing so.

Between 2004 and 2008, XY Partnership and XYCL claimed deductions in their income tax returns for the insurance payments. ZK Accountants prepared the accounts and tax returns, only questioning whether the promissory notes had been signed but without enquiring into whether the recipient of the promissory notes had in fact been duly registered as an insurer. Evidence was given by the Accountant that she did not believe that issue to be relevant and that she had advised the disputants that they were entitled to the deductions. In hindsight, she accepted that this advice was "possibly incorrect".

For commercial and other reasons, it was ultimately decided in late 2008/early 2009 not to proceed with the registration of CQ Construction as an insurer. ZK accountants advised that the "insurance payments" claimed as deductions would now need to be reversed. This advice was acted upon in the 2008 and 2009 income tax returns.

Following a GST audit in April 2010, it was decided to widen the investigation to include XY Partnership's and XYCL's income tax returns.

The investigator's requests between November 2010 and June 2011 for the disputants to provide information and documents relating to the insurance scheme were not complied with. Eventually in February 2012 the investigator met with the disputants and was told about the intention to set up a self-insurance scheme through an Australian company, but for financial reasons had decided not to proceed as it involved payment of $500,000 to the Federal Government. Mr AB also confirmed that there were no documents relating to the proposed insurance scheme.

Following the meeting, the investigator prepared a memorandum to the departmental officer with the requisite delegate authority to reopen the time-barred income tax assessments under s 108(2)(a) of the TAA on grounds that the returns were fraudulent or wilfully misleading and involved an income equalisation scheme.

The Commissioner in later documents considered that the captive insurance arrangements did not amount to such a scheme, but based on other facts set out in the memorandum decided to proceed with opening the time bar and issued a Notice of Proposed Adjustment.

The disputants accepted that the deductions were wrongfully made and they were not entitled to them, but challenged the Commissioner's decision under s 108(2)(a) of the TAA to open the time bar for amending the assessments.

Decision

The Taxation Review Authority ("TRA") acknowledged that s 108(2)(a) of the TAA requires the Commissioner to do nothing more than form an opinion that a tax return is fraudulent or wilfully misleading. An opinion is not a concluded state of mind and is not formed as part of an

adjudicative process or necessarily with full knowledge of the facts.

Ability to challenge the correctness of the Commissioner's opinion

The disputants argued in reliance on *C of IR v Legarth* ([1969] NZLR 137 (CA)) that the TRA or High Court must form its own view of whether the returns are fraudulent or wilfully misleading.

The TRA did not accept the disputants' line of reasoning which had been considered in *Vinelight Nominees Limited v C of IR* (HC Auckland CIV 2005-404-2774, 22 July 2005), *Vinelight Nominees Limited v C of IR* (No 2) ((2005) 22 NZTC 19,519) and confirmed in *Auckland Institute of Studies Limited v C of IR* ([2002] 20 NZTC 17,685).

These cases set out that the TAA provides for two distinct steps as part of the reassessment process. First, the need for the Commissioner to form an opinion, and second, for the Commissioner to reassess. It is only the second part of this process which can be challenged in substance.

It is clear that the taxpayer cannot challenge the correctness of the Commissioner's opinion (that the returns were fraudulent or misleading) and the Hearing Authority (the TRA or High Court) may not substitute its own opinion for that of the Commissioner. A taxpayer may only challenge whether the Commissioner honestly held the opinion and the principal issue in this case is whether on the basis of the information available to her, it was reasonably open to the Commissioner to come to the opinions that she did.

Was it reasonably open to the Commissioner to come to her opinions?

The TRA discussed the definitions of fraudulent or wilfully misleading and held that having the knowledge and intention that the returns are wrong or being reckless as to whether or not they are wrong is sufficient to meet the "fraudulent or wilfully misleading" test under s 108(2) of the TAA. The Commissioner was required to form an opinion of the disputants' state of mind when filing the returns on the basis of the evidence before her.

The TRA rejected submissions from the disputant that relevant information had been ignored and that due regard had not been had to the fact that the disputants voluntarily reversed the deductions claimed prior to any audit notification.

It was also argued by the disputants that when the Commissioner rejected the notion of the income equalisation scheme, there was no longer any basis on which to contend that the disputants had been fraudulent or wilfully misleading. This argument was rejected by the TRA which held that the Commissioner was entitled to form the view she did on the basis of the remaining facts in the memorandum.

Based on the evidence before the Commissioner, the TRA held that the Commissioner's opinion had been both honest and reasonably open to her.

Shortfall penalties under s 141E of the TAA or s 141C of the TAA

Under s141E(1)(a) of the TAA, the Commissioner can impose 150% shortfall penalties if the taxpayer evades the assessment or payment of tax.

The TRA held that the required state of mind for an "evasive intent" is a subjective test of whether the taxpayer had knowledge that the act or omission intended was wrong or acted deliberately or recklessly as to whether or not it was wrong. The TRA held that the Commissioner had not discharged the onus of proving that Mr AB on a subjective assessment did have the required evasive intent.

Instead, the TRA was satisfied that the disputants' actions amounted to gross carelessness under s 141C(1) of the TAA and that the shortfall penalty should accordingly be assessed as 40%. The test under this section is an objective one and given what Mr AB had been advised by the tax specialist, he should reasonably have made inquiries to check that the absence of a proper structure being put in place did not prevent the disputants from claiming the deductions.

DEDUCTIBILITY OF MANAGEMENT FEES/TAX AVOIDANCE

Case	TRA 013/10 [2015] NZTRA 10
Decision date	29 June 2015
Act(s)	Income Tax Act 1994, Tax Administration Act 1994
Keywords	Section BD 2, s BG1, s 141D, deductibility, incurred, management fees, tax avoidance

Summary

The Taxation Review Authority ("TRA") found for the Commissioner of Inland Revenue ("the Commissioner") on the basis there was no evidence that management services were provided and that the Q Land Trust ("the Trust") incurred the management fees. The TRA was also satisfied the arrangement was one of tax avoidance.

Impact

This decision confirms that a deduction is available only where the expenditure has the necessary relationship both with the taxpayer concerned and with the gaining or

producing of his assessable income, or with the carrying on of a business for that purpose.

Facts

The disputant is the corporate trustee of the Trust. The disputant challenged the Commissioner's assessment that disallowed $1,116,000 claimed as a deduction for a management fee expense paid by the disputant to Q Land Limited ("Land Limited") in the 2005 income tax year.

Mr X was the settlor and a discretionary beneficiary of the Trust. Mr X was also shareholder and director of the disputant.

The Trust purportedly undertook management services for related companies and trusts. The Trust did not have any employees and at all material times it used management services provided by Land Limited to manage its property and other business interests. There was no written management agreement between the Trust and Land Limited.

Mr X gave evidence that Land Limited incurred significant costs in undertaking management services for the Trust in the income tax year ended 31 March 2005. Mr X also gave evidence that Land Limited engaged Mr X and Mr Y through their respective management companies to provide management services. However, no formal agreements were executed in relation to the provision of these services.

The financial statements of the Trust for the 2005 year record management fees totalling $1,152,824 as an expense to the Trust. $1,116,000 of this sum is recorded as being management fees paid to Land Limited.

Without the management fee expense the Trust would have recorded income of $1,685,529 in the 2005 year. After the distribution of dividend income, the Trust would have had trustee income of $1,116,000 with tax to pay of $368,280. The management fee expense had the effect that the Trust then had no tax to pay.

The Commissioner disallowed the management fee expense on two grounds:

1. that it was not incurred in the derivation of gross income, or necessarily incurred in the course of carrying on a business for the purpose of deriving the disputant's gross income and was not therefore deductible under s BD 2 of the Income Tax Act 1994 ("ITA"); or
2. alternatively, if the management fee meets the requirement of s BD 2, it was part of a tax avoidance arrangement under s BG 1 of the ITA, which is void against the Commissioner for tax purposes.

The Commissioner also sought to impose a shortfall penalty for taking an abusive tax position or in the alternative, for taking an unacceptable tax position (in both cases reduced by 50%).

Decision

Deductibility under s BD 2 of the ITA

Section BD 2(1)(b) of the ITA allows a taxpayer a deduction for an amount of expenditure or loss to the extent it is either:

(i) incurred by the taxpayer in deriving the taxpayer's gross income; or

(ii) necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income.

The TRA referred to the relevant case law on deductibility which made it clear a deduction is available only where the expenditure has the necessary relationship both with the taxpayer concerned and with the gaining or producing of his assessable income, or with the carrying on of a business for that purpose.

The TRA agreed with the Commissioner's submission that an entry in the Trust's financial statements recording a management fee expense does not establish that management services were provided. It found there was no evidence of any company resolution or any agreement between the Trust and Land Limited for the charging of management services, and there was no invoice for the management fee or supporting accounts for any of the work allegedly done.

The TRA concluded that the management fee was not deductible under s BD 2 of the ITA. It was not satisfied on the evidence that management services were provided and that the management fee was incurred by the Trust. Accordingly, it was not satisfied that there was the requisite nexus between the management fee of $1,116,000 (or any part thereof) and the gaining or producing of the Trust's assessable income or the carrying on of its business.

Tax avoidance

The TRA went on to consider whether the transaction is part of a tax avoidance arrangement under s BG 1 of the ITA, in the event it was wrong in finding the management fee was not deductible under s BD 2.

The TRA stated that the general avoidance provision does not confine the court as to the matters that may be taken into account when considering whether a tax avoidance arrangement exists.

The TRA found the whole transaction to be contrived and artificial and that it made no commercial sense. It was

satisfied that one of the purposes of the arrangement was the avoidance of tax. Accordingly, the TRA was of the view that the tax avoidance purpose or effect of the arrangement was not merely incidental and as such, the arrangement is void against the Commissioner in accordance with s BG 1.

The TRA was also satisfied that the disallowance of the deduction claimed by the Trust was the only step required to be taken by the Commissioner to counteract the tax advantage.

Shortfall penalty

The TRA considered that it could not be said (on any basis) that when viewed objectively the tax position adopted by the disputant was "about as likely as not to be correct".

The TRA was satisfied that when viewed objectively under either the deductibility provisions or an anti-avoidance arrangement, the transaction had a dominant purpose of avoiding tax. Accordingly, the TRA imposed a shortfall penalty under s 141 D of the TAA for taking an abusive tax position reduced by 50% for previous good behaviour under s 141FB.

SUPREME COURT AWARDS INDEMNITY COSTS

Case	Bradbury Peebles and Anors v Commissioner of Inland Revenue and Anors
Decision date	8 June 2015
Act(s)	Insolvency Act 2006
Keywords	Provable debt, indemnity costs, collateral attack, abuse of process

Summary

This is a costs judgment following the Supreme Court's earlier decision on 2 December 2014 to dismiss three related applications for leave to appeal. The appellants in each appeal were investors in the Trinity tax avoidance scheme.

The Commissioner of Inland Revenue ("the Commissioner") (and others) applied for indemnity costs. Those applications were complicated by the bankruptcy and liquidation of a number of the appellants.

The Supreme Court noted that the established position in New Zealand is that costs made after adjudication in bankruptcy in respect of proceedings which had been commenced before adjudication were not provable in bankruptcy. The Supreme Court (following a recent English authority) reversed that position and held that costs awards following adjudication can be provable as a contingent liability. The judgment is also notable for the fact that the Supreme Court took the unusual step of awarding indemnity against the appellants.

Impact

The impacts of the decision are as follows:

1. For Trinity investors, bringing litigation that is an abuse of process or a collateral attack on the Supreme Court judgment(s) in Trinity will likely lead to an award of indemnity costs in favour of the Commissioner.
2. For an individual, court costs awarded after bankruptcy, where the proceedings commenced prior to the adjudication in bankruptcy, are a debt provable in the bankruptcy.
3. For a company, court costs awarded after being placed into liquidation, where the proceedings commenced prior to the appointment of a liquidator, are a debt provable in the liquidation.

Facts

This case concerned the judgment of the Supreme Court delivered on 2 December 2014 dismissing three related applications for leave to appeal. All the appellants were investors in the Trinity tax avoidance scheme.

The Judicial Conduct Commissioner, Justice Venning and the Commissioner subsequently applied for indemnity costs. Complicating the determination of those applications was the bankruptcy and liquidation of a number of the appellants.

Decision

Costs in respect of SC 90/2014 – Accent Management Ltd

Both the High Court and Court of Appeal awarded indemnity costs against the appellant. The Supreme Court considered that for the same reasons given by those courts, and by the Supreme Court in refusing leave, an award of indemnity costs is warranted in favour of the Commissioner.

Costs in respect of SC 87/2014 and SC 103/2014 – Messrs Bradbury and Peebles

Debts provable in the bankruptcy

A series of English cases had held that an order for costs made after adjudication in bankruptcy in respect of proceedings that had been commenced before adjudication were not provable in bankruptcy.

These English cases were recently overruled by the Supreme Court of the United Kingdom in *Re Nortel GmbH* ([2013] UKSC 52, [2014] AC 209) ("*Nortel*"). That judgment focused primarily on a rule that the New Zealand Supreme Court considered very similar in expression to s 232(1) of the Insolvency Act 2006. It was found in *Nortel* that an order

for costs made against a company in liquidation, made in proceedings begun before it went into liquidation, is provable as a contingent liability.

The New Zealand cases proceeded on the basis that costs awarded after adjudication in bankruptcy are not provable in the bankruptcy. This has been so in relation to both s 232 of the Insolvency Act 2006 and (on a historical note) s 87 of the Insolvency Act 1967. The New Zealand courts simply followed, directly or indirectly, the English cases which have now been overruled by *Nortel*.

The Official Assignee accepted that *Nortel* should be regarded as the controlling authority and the Supreme Court was satisfied that the approach in *Nortel* should now be followed in New Zealand.

SC 87/2014

The Court held that indemnity costs are appropriate given what was proposed was a collateral attack on its judgment in *Ben Nevis Forestry Ventures v Commissioner of Inland Revenue* ([2008] NZSC 115, [2009] 2 NZLR 289).

SC 103/2014

The Court held that the proceedings were an abuse of process and an order for indemnity costs was appropriate.

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