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TAX INFORMATION
Bulletin

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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
ED0183	Draft SPS: Child support and domestic maintenance – amendments to assessments, standard practice statement	This SPS sets out how the Commissioner will exercise the discretion under s 87 of the Child Support Act 1991. This includes assessments the Commissioner makes as a result of a voluntary agreement entered into by parties.	24 March 2016
ED0184	Draft operational statement: Filing an IR 10 and section 108 of the Tax Administration Act 1994	This statement amalgamates and replaces several statements from Inland Revenue about income disclosure by taxpayers who complete an IR 10 rather than provide their financial statements when furnishing their annual tax return.	24 March 2016

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Liability for PAYE: Were the shares held on bare trust?

This case was about whether the disputant was liable to pay PAYE on monthly payments made to Mr X. The disputant argued that Mr X was a shareholder of the disputant and therefore the disputant was not required to return the PAYE owing as the monthly payments were not PAYE income payments to Mr X. Deciding whether MR X was a shareholder of the disputant turned on whether Mr A (sole registered shareholder of the disputant) held shares in the disputant for Mr X on bare trust.

BINDING RULINGS

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

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

PRODUCT RULING BR PRD 15/05: AA SMARTFUEL LIMITED

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by AA Smartfuel Limited.

Taxation Laws

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

This Ruling applies in respect of ss 2, 3A, 6, 8, 20 and 25(1)(b).

The Arrangement to which this Ruling applies

The Arrangement is the AA Smartfuel Programme (the Programme). This is a rewards scheme where customers obtain entitlements to buy fuel at a discounted price from certain fuel providers by purchasing goods or services from certain retailers (Participating Reward Providers (PRPs)). The fuel providers may also be PRPs in respect of both fuel and non-fuel purchases.

This Ruling applies only to PRPs that are "registered persons" (as defined in s 2).

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

Parties to the Arrangement

1. The Arrangement involves the following parties:
   - AA Smartfuel Limited (AASL) as the scheme operator and administrator;
   - various fuel providers, which currently include BP Oil New Zealand Limited (BP) and Chevron New Zealand;
   - various PRPs, which currently include BP for non-fuel purchases;
   - individual people who join the scheme (customers).
2. The AA Smartfuel website (**www.AAsmartfuel.co.nz**) lists participating PRPs and fuel providers current at any time. PRPs and fuel providers may be subject to change.
3. Individuals are also able to join the Programme through one of the following two ways:
   - All AA members are automatically enrolled in the Programme.
   - Non-AA members can obtain a free AA Smartfuel card at PRPs and fuel providers. They need to complete an application form online or in hard copy to be able to redeem their discounts.

Documents relevant to the Arrangement

4. The documents relevant to the Arrangement are:
   - AA Smartfuel Terms and Conditions, which relate to customers;
   - AA Smartfuel Merchant Agreement, entered into between AASL and PRPs (PRP Agreement);
   - AA Smartfuel National Fuel Merchant Agreement, entered into between BP and AASL (BP Agreement);
   - AA Smartfuel Issuer Agreement, entered into between Chevron New Zealand and AASL (Chevron Agreement);
   - AA Smartfuel Fuel Merchant Agreement, entered into between the individual Caltex Service Stations and AASL (Caltex Service Station Agreements).
5. The actual agreements entered into between the individual Caltex Service Stations and AASL will not be materially different from the draft AA Smartfuel Merchant Agreement attached as an appendix to the Chevron Agreement provided to Inland Revenue on 23 June 2015.

Summary of the AA Smartfuel Programme

6. The Programme is a nationwide rewards scheme, which was launched to the public on 7 November 2011. Under the Programme, a customer will earn an entitlement to a discount on the purchase of fuel from fuel providers by purchasing qualifying goods or services from a PRP. The fuel discount entitlements will be credited to a card issued to the customer on presentation of that card to the PRP when making qualifying purchases.

7. All fuel discount entitlements earned from all PRPs accumulate on the customer's card as they make qualifying purchases from PRPs. Fuel discount entitlements expire at the end of the month following the month in which the purchases are made (eg, a fuel discount entitlement earned in August will expire on 30 September).
8. The fuel discount entitlements will provide the customer with the right to a discount on the GST-inclusive price of fuel from fuel providers, expressed as cents per litre, limited to a maximum of 50 litres of fuel. For example, a PRP may credit the customer's card with a fuel discount entitlement of 4 cents per litre, which amounts to a $2 discount including GST on a purchase of 50 litres of fuel. Each PRP can set the level of fuel discount entitlement they offer and can set special fuel discount entitlements (eg, if a promotion is done over a period of time) by logging into the AA Smartfuel platform and adjusting the cents discount per dollar spent.
9. Customers will be able to check their fuel discount entitlement balance online. Generally, both types of customers (AA and non-AA members) will be entitled to the same deals, but AA may occasionally offer a special deal to its members.
10. When a customer purchases fuel from a fuel provider and presents the provider with their card, the accumulated discounts on the card will be credited against the purchase price of the fuel (petrol, diesel or both), up to a maximum of 50 litres. The customer then pays a discounted amount. Accumulated discounts on the reward card could be sufficient to discount up to 50 litres of fuel purchased.

Payment flows involving AA Smartfuel Limited

11. When a customer makes a qualifying purchase from a PRP and earns a fuel discount entitlement, the PRP must pay an amount equivalent to the value of the discount entitlement to AASL. This is currently described in cl 4.1 of the PRP Agreement, cl 5.1 of the Chevron Agreement and cl 4.1 of the BP Agreement (this latter clause being materially the same as the clauses in the PRP Agreement and the Chevron Agreement). Each week on Sunday night, AASL will determine the total amount of discounts provided to customers in the preceding week and either:
    - AASL will send a tax invoice to the PRP; or
    - (if s 24(2) is satisfied) the PRP will send a buyer created tax invoice to AASL.

    The PRP will pay the amount on Tuesday night.
12. Clause 4.1 of the PRP Agreement states:

    > 4.1 In consideration of us undertaking to procure the Participating Redemption Parties' agreement to honour the rights arising from AA Smartfuel Discounts awarded by you each week, you undertake to pay us an amount equal to the aggregate amount of AA Smartfuel Discounts sponsored and awarded by you to AA Smartfuel Members at each of the Business Premises each week (including any AA Smartfuel Discounts awarded under clause 13.2) which amount will be paid irrevocably by you to the AA Smartfuel Account by direct debit, weekly in arrears on Tuesday of the week following the week in which the relevant AA Smartfuel Discount Award Transactions occurred.

13. When a customer redeems their discount entitlement by purchasing fuel from a fuel provider and presenting their AA Smartfuel card, AASL will pay the fuel provider an amount equivalent to the discount given, as currently described under cl 4.4 of the BP and Caltex Service Station Agreements. The AA Smartfuel system will identify transactions when fuel discount entitlements are redeemed, and each week either:
    - the fuel provider will issue a tax invoice to AASL; or
    - (if s 24(2) is satisfied) AASL will issue a buyer created tax invoice to the fuel provider.

    The payment to the fuel provider is made on Thursdays by AASL.
14. For instance, cl 4.4 of the BP Agreement states:

    > 4.4 In consideration of you honouring the redemption of AA Smartfuel Discounts, we will pay you an amount equal to the aggregate amount of AA Smartfuel Discount redemptions honoured for AA Smartfuel members at each of the Business Premises each week, less the aggregate value of any AA Smartfuel Discounts issued by you on transactions where AA Smartfuel Discounts have been awarded and redeemed in the same transaction. We will pay you from the AA Smartfuel Account by direct debit, weekly in arrears on the Thursday of the following week.

15. Reference can also be made to cl 4.4 of the Caltex Service Station Agreements, which is materially the same as the BP Agreement other than the reference to discounts being awarded and redeemed in the same transaction.
16. To the extent any fuel discount entitlements are not used before expiry, either:
    - AASL will issue a credit note to the PRP, or
    - (if s 25(3A) is satisfied) the PRP will issue a buyer created credit note to AASL.

AASL will then refund an amount equivalent to the unused discount to the relevant PRP. This is currently described in cl 4.2 of the PRP Agreement, cl 4.2 of the BP Agreement and cl 5.1 of the Chevron Agreement, (cls 4.2 of the BP Agreement and 5.1 of the Chevron Agreement are materially the same as cl 4.2 of the PRP Agreement). This amount is then paid out within 10 days.

17. Clause 4.2 of the PRP Agreement states:

> 4.2 Where the AA Smartfuel Discounts sponsored and awarded by you (and paid for under clause 4.1) have expired (by passage of time or because they are in excess of your Pro Rata Share of the AA Smartfuel Discounts redeemed in an AA Smartfuel Discount Redemption Transaction), the amount of the consideration payable by you under clause 4.1 will be reduced and an amount equal to the amount of such reduction will be paid to you in respect of the relevant Business Premises by direct credit on or about the 10th of the month following the month in which the AA Smartfuel Discounts expired.

18. The fuel providers and PRPs also make additional payments to AASL for other services AASL provides in respect of the information technology platform that enables it to operate the Programme, as well as administration, establishment, transaction and other sundry fees.

Instant discounts by fuel providers

19. The Ruling does not apply to the provision of an "instant discount" by a fuel provider, being part of any discount on the price of goods or services supplied by a fuel provider to a customer that is not referable to points accumulated under the Programme and does not result in a PRP having to reimburse the fuel provider.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The sale of goods and services by a PRP results in the customer providing "consideration" (as defined in s 2) for a single supply of goods and services and the right to buy fuel at a discount under s 6. To the extent the PRP makes a taxable supply to the customer, the amount paid by the customer is subject to GST under s 8.
- Payments AASL makes to a fuel provider are "consideration" (as defined in s 2) for a taxable supply of services from the fuel provider to AASL. The amount AASL pays to the fuel provider is therefore subject to GST under s 8.
- In calculating the amount of tax payable in a taxable period under s 20, AASL will be entitled to an input tax (as defined in s 3A) deduction for all the GST charged in respect of supplies made by a fuel provider to AASL in that taxable period.
- Where a customer uses fuel discount entitlements to purchase fuel at a discounted price, under s 8(1) GST on that supply is chargeable only on the discounted price payable by the customer to the fuel provider.
- Payments a PRP makes to AASL are "consideration" (as defined in s 2) for a supply of services from AASL to the PRP. The amount the PRP pays to AASL is therefore subject to GST under s 8.
- To the extent that the single supply (comprising of goods and services and the right to buy fuel at a discount) made by a PRP to a customer is a taxable supply, in calculating the amount of tax payable in a taxable period under s 20 the PRP will be entitled to an input tax (as defined in s 3A) deduction, or (where s 20(3) applies) a deduction from the amount of output tax payable by that PRP, for the GST charged on supplies made by AASL to the PRP in that taxable period.
- When an amount is refunded to a PRP under cl 4.2 of the relevant Agreement, s 25(1)(b) will apply and either:
  - AASL will be required to provide the PRP with a credit note, or
  - (if s 25(3A) is satisfied) the PRP will be required to provide AASL with a buyer created credit note.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 January 2015 and ending on 31 December 2017.

This Ruling is signed by me on the 21st day of December 2015.

Howard Davis

Director (Taxpayer Rulings)

PRODUCT RULING BR PRD 15/06: FONTERRA CO-OPERATIVE GROUP LIMITED

Name of the person who applied for the Ruling

This Ruling has been applied for by Fonterra Co-operative Group Limited (Fonterra).

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CD 4, CD 5, CD 6, CX 56, CX 56B, DA 1, DB 23, subpart HM, and the definition of "foreign investment variable-rate PIE" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of the Fonterra Shareholders' Fund (FSF), a New Zealand resident unit trust through which non milk-supplying investors (Public Investors) and farmers supplying milk to Fonterra (Supplying Shareholders) are able to invest in units. Units in the FSF give Public Investors and Supplying Shareholders economic rights in Fonterra shares (Shares), but do not provide them with any legal interest in the Shares.

Units in the FSF are issued when a Supplying Shareholder, registered volume provider (RVP) (whose Shares are held in the name of the Custodian on trust for the RVP), or Fonterra transfers the legal ownership of Shares to Fonterra Farmer Custodian Limited (Custodian). The Custodian holds the economic rights in those Shares on trust for The New Zealand Guardian Trust Company Limited as trustee of the FSF (Unit Trustee).

The FSF was established in November 2012. Trading in FSF Units commenced on the NZX Main Board at 12 pm on 30 November 2012. A total of 95,454,545 Units were on issue at that date, for a total consideration of NZ$525 million.

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

Parties to the Arrangement

1. The parties to the Arrangement are:
   - Fonterra;
   - The FSF (through the Manager or Unit Trustee);
   - Kevin Turnbull, Malcolm Bailey and Brian Todd in their capacity as trustees of the Fonterra Farmer Custodian Trust (the Farmer Trustees);
   - The Custodian;
   - Unit Trustee;
   - FSF Management Company Limited as manager of the FSF (Manager);
   - Supplying Shareholders;
   - RVPs; and
   - Public Investors.
2. Supplying Shareholders, RVPs, the Farmer Trustees, Fonterra and Public Investors may invest in the FSF. Together, they are referred to as the Unit Holders.

Documents relevant to the Arrangement

3. The following documents are relevant to the Arrangement:
   - Fonterra Shareholders' Fund Unit Trust Deed dated 23 October 2012 (which established the FSF) (Unit Trust Deed);
   - Fonterra Shareholders' Fund Authorised Fund Contract dated 25 October 2012, under which the FSF was established as an "Authorised Fund" under Fonterra's Constitution;
   - Deed of Trust establishing the Fonterra Farmer Custodian Trust dated 25 October 2012, which holds all of the shares in the Custodian and the Fonterra Unit;
   - Custody Trust Deed for the Fonterra Economic Rights Trust dated 25 October 2012, under which the Custodian holds the legal title to Shares, and holds the economic rights in Shares on trust for the Unit Trustee; and
   - Constitution of Fonterra Co-operative Group Limited dated 30 November 2012 (Constitution), which came into force in December 2012 when Trading Among Farmers was implemented.

Background to the Arrangement

4. Fonterra is simultaneously registered as a co-operative dairy company under Part 3 of the Co-operative Companies Act 1996 and as a company under the Companies Act 1993 (Companies Act). Many aspects of Fonterra's structure and operation are governed by the Dairy Industry Restructuring Act 2001 (DIRA).
5. Supplying Shareholders must generally hold such number of Shares as is determined by the share standard (currently set in Fonterra's Constitution as being one share for each kilogram of milksolids obtainable from milk supplied by the farmer in that season, save that Shares cannot be issued to a farmer whose supply of milksolids is less than 1,000kg in a season). These Shares are informally known as "wet" shares, as they are backed by the supply of milk. In

practice, Supplying Shareholders must indicate in advance how much milk they wish to supply in a coming season, and they must acquire or dispose of the appropriate number of Shares in order to back that supply (within certain margins). Supplying Shareholders may also comply with the share standard through the holding of "vouchers" (discussed further in paragraph 29 below).

6. In addition to their "wet" Shares, Supplying Shareholders may acquire further Shares (currently up to 100% of the number of shares that they are required to hold under the share standard). These Shares are informally known as "dry" Shares, as they are not backed by the supply of milk. Despite the informal distinction between wet Shares and dry Shares, all Shares of Fonterra belong to a single class of Shares.

7. Prior to the implementation of Trading Among Farmers, s 98 of the DIRA required Fonterra to pay a surrender value for Shares when a notice of withdrawal was given by a Supplying Shareholder under s 97 of the DIRA. The ability for farmers to surrender their Shares in this way had led to volatility in Fonterra's capital. For example, the surrender value for Shares withdrawn in 2008 was approximately $600 million as a result of droughts occurring in 2008, with production increasing to pre-drought levels in 2009. Fonterra referred to this volatility as redemption risk.

8. To address this redemption risk, Fonterra made a number of changes to its capital structure in three stages. The changes, referred to as Trading Among Farmers, included:

   - enabling farmers to acquire up to 100% of the number of Shares that they are required to hold under the share standard as dry Shares.
   - the establishment of a Fonterra Shareholders' Fund to enable public investment (ie the FSF).
   - the creation of a "private market" for the trading of Shares between Supplying Shareholders, RVPs (whose Shares are held in the name of the Custodian in trust for the RVP) and Fonterra (the Fonterra Shareholders' Market (FSM)). Fonterra is involved in the FSM so that it can manage the size of the FSM by conducting buybacks of Shares.

9. The Trading Among Farmers changes required amendments to be made to the DIRA, to remove the requirement for Fonterra to accept the surrender of Shares on request. This amendment was brought into force in November 2012 by Order-in-Council and removed the redemption risk.

The Arrangement

10. The FSF is a passive investment vehicle through which a Public Investor can invest indirectly in Fonterra. The FSF was established as a unit trust under the Unit Trusts Act 1960 on 23 October 2012.

11. The FSF has elected to be a "foreign investment variable-rate PIE" (as defined in s YA 1) and to use the exit calculation option (under s HM 42), and the Commissioner confirmed this by letter dated 13 November 2012.

12. The purpose of the FSF is to provide support to the FSM by acting as a conduit for Public Investors to access the underlying economic rights in a Share, thereby creating a more liquid market for Supplying Shareholders (and RVPs) to trade in Shares. This mechanism allows Supplying Shareholders to sell economic rights in Shares to the FSF, as well as selling Shares on the FSM. It also allows an RVP to move between the FSF and FSM to match supply and demand and possibly hedge its position. While Supplying Shareholders may invest in the FSF, most of the Unit Holders are not Supplying Shareholders.

The RVPs

13. Fonterra has appointed one RVP, Craigs Investment Partners (although it retains the discretion to appoint further RVPs), to acquire and dispose of Shares (through the Custodian) on the FSM to facilitate trades and liquidity in that market. The principal duties of the RVPs are to ensure the smooth execution of transactions and improve liquidity through continuous quoting of both buy and sell orders with a contracted maximum spread between the buy and sell prices quoted. A key role of the RVPs is to ensure that the spread between buy and sell prices is restricted to a narrow range.

14. Under the Constitution, RVPs must hold, in aggregate, rights or interests in no more than 5% of the total Shares on issue at any time, excluding treasury stock (such Shares being held in the name of the Custodian in trust for the RVP). Fonterra and the RVPs have not and will not enter into a risk sharing agreement, however where the RVP is suspended from selling economic rights in relation to Fonterra shares to the FSF, Fonterra will compensate the RVP for certain trading losses suffered by the RVP.

15. Like Supplying Shareholders, RVPs are also able to participate in the FSF. This promotes price convergence between the FSM and the FSF.

The Unit Trustee, the Manager and the Custodian

16. Fonterra appointed the initial Unit Trustee as trustee of the FSF. The Unit Trustee holds a licence under the Securities Trustees and Statutory Supervisors Act 2011.

17. Fonterra also appointed the initial Manager of the FSF. The initial Manager is a company wholly owned by Trustees Executors Limited. Under the Unit Trusts Act 1960, the role of the Manager is to manage the investments of the FSF and issue Units to the public. The Manager manages the FSF as an investment vehicle and does not undertake an active role (such as actively soliciting farmers to sell economic rights in their Shares). Fonterra provided a licence (the Licence) to the Manager to use Fonterra's name and brand for the purposes of the FSF.

18. The Unit Trustee and Manager are party to an arrangement (the Funding Arrangement) with Fonterra under which Fonterra provides the FSF with funds at the start of each financial year to cover the reasonable expenses incurred by the FSF, or the Manager, on behalf of the FSF (Operating Expenses) in accordance with a Budget agreed between the parties.

19. The Custodian is a limited liability company set up to hold legal title to Shares. The Custodian holds legal title to any Shares in which economic rights have been sold to the FSF, and holds the economic rights in Shares on trust for the Unit Trustee (under the Fonterra Economic Rights Trust). The Custodian also holds legal title to any Shares acquired by the RVP, on trust for the RVP (under a separate trust from the Fonterra Economic Rights Trust).

20. The Custodian is wholly-owned the Farmer Trustees, as trustees of the Fonterra Farmer Custodian Trust. The Fonterra Farmer Custodian Trust is a trust set up for the sole purpose of holding the shares in the Custodian and the Fonterra Unit, which confers on the holder rights to prevent certain changes to the Unit Trust Deed (see further discussion at paragraph 38 below). The Farmer Trustees are three farmer representatives (a farmer directly elected by Supplying Shareholders, a director of Fonterra elected by Supplying Shareholders, and a member of the Fonterra Shareholders' Council). The discretionary beneficiaries of the trust are Supplying Shareholders and Fonterra is the final beneficiary of the trust.

21. The Custodian (and the FSF) do not have any voting rights in Fonterra under Fonterra's Constitution, which restricts voting rights to Supplying Shareholders (ie production based voting rights), except at a meeting of an interest group where there would otherwise be no shareholder entitled to vote at that meeting under clause 24.2(c) of the Constitution. Under clause 7.8 of the Constitution, the Authorised Fund Contract is required to prohibit the FSF and the Custodian from exercising, controlling or exerting any influence over any voting rights attached to the Shares. The Unit Trust Deed and Custody Trust Deed also contain provisions preventing the FSF and the Custodian from exercising any influence over voting rights attached to the Shares.

22. Under clause 7.1 of the Custody Trust Deed, the income of the Fonterra Economic Rights Trust includes amounts of deemed income that arise under tax law and the Custodian is permitted to distribute this income to the FSF.

Operation of the FSF

23. The operation of the FSF is described in the paragraphs below.

24. Supplying Shareholders, RVPs and Fonterra can transfer economic rights in Shares to the FSF. In this context, "economic rights in Shares" means the rights to receive dividends and other benefits derived from a Share, including any change in value of the Share, as well as the other rights and benefits comprised in the Share. It does not include any right to hold the legal title to a Share or a security convertible to a Share, or to exercise production-based voting rights.

25. The process for selling economic rights in Shares to the FSF involves two steps:

    - Supplying Shareholders, RVPs, and Fonterra transfer legal title to a Share to the Custodian (legal title to the Share does not pass to the FSF); and
    - The Custodian holds the economic rights in the Shares on trust for the Unit Trustee.

26. The economic rights in Shares are the FSF's only material asset. Under clause 7.5 of the Constitution, the aggregate number of Shares in which the FSF may acquire economic rights is limited to 20 percent of the total number of Shares on issue (excluding treasury stock). If this limit is exceeded the Board of Fonterra is obliged to take steps to bring the number of Shares in respect of which the economic rights are held for the FSF back within the limit within an appropriate timeframe (clause 7.6 of the Constitution).

27. Units in the FSF are issued by the Manager upon the Custodian receiving a Share, which gives rise to the receipt of economic rights in a Share by the FSF. In addition, if Fonterra issues further Shares in respect of a Share held by the Custodian (in respect of which economic rights are being held in favour of the Unit

Trustee), the FSF will issue a corresponding number of Units to its Unit Holders pursuant to clauses 15.1(d) and (e) of the Unit Trust Deed. This ensures that the number of Shares placed with the Custodian in which economic rights are being held in favour of the Unit Trustee will always equal the number of Units on issue. Clauses 15.1(a) and (b) of the Unit Trust Deed provide for the payment of cash dividends or other cash benefits to Unit Holders, mirroring payments on the Shares, as follows:

> a) upon receipt of a cash dividend or other cash Benefits (other than a Supplementary Dividend) paid by Fonterra, this will be distributed to Unit Holders who were recorded in the Register at the same time and on the same record date as applied by Fonterra to determine the entitlement to the cash dividend or other cash Benefits. The amount to be paid or transferred to each such Unit Holder in respect of each Unit held by that Unit Holder as at that time, will be equal to the amount Fonterra paid or transferred per Share adjusted to take into account any Tax Liability of the Trust relating to the Unit Holder or any adjustments in accordance with section HM 48 of the Tax Act, and less any non-resident withholding tax deducted in respect of the Unit Holder in accordance with subpart RF of the Tax Act pursuant to section HM 44B of the Tax Act and less any sum authorised in accordance with an Extraordinary Resolution pursuant to paragraph 11.1(b)(viii) of Schedule 1;
>
> b) upon receipt of any Supplementary Dividend paid by Fonterra, this will be distributed to the Unit Holders that entitled Fonterra to apply section LP 2 of the Tax Act and receive a tax credit for the Supplementary Dividend;

28. Each Supplying Shareholder or RVP who transfers Shares to the Custodian (in which economic rights have been sold to the FSF) receives either one Unit in the FSF for each such economic right in a Share transferred or a cash sum (clause 5.1 of the Unit Trust Deed) in recognition of the transfer of the economic right in the Share to the FSF. Units received by Supplying Shareholders in consideration for the transfers of Shares to the Custodian (in which economic rights have been sold to the FSF) are not able to be retained by the relevant Supplying Shareholder, and must be sold on the NZX Main Board or ASX to settle a sale contract previously entered into on the relevant market.

29. Supplying Shareholders who sold economic rights in "wet" Shares to the FSF as part of the establishment of Trading Among Farmers (and as part of a subsequent one-off offer by Fonterra to purchase Units in October 2012) also received "vouchers" that count towards the share standard and support production-based voting rights and the right to full share backed milk price (clause 5.3 of the Unit Trust Deed). Fonterra's Constitution gives the Fonterra Board the discretion to permit Supplying Shareholders to sell the economic rights in "wet" Shares to the FSF on a day-to-day basis and (subject to individual limits) to receive "vouchers" in partial consideration for the sale of those economic rights. While the Board keeps this policy under review, Supplying Shareholders are not currently entitled to sell economic rights in "wet" Shares to the FSF or to receive "vouchers" in connection with such sale.

30. Under the Unit Trust Deed, each Unit issued by the FSF evidences the entitlement of the holder to the economic benefits (including distributions and other benefits) in the whole of the trust fund. As the number of Units issued by the FSF equals the number of Shares held by the Custodian (in which economic rights are being held in favour of the Unit Trustee), in effect each Unit provides rights to receive the distributions and other benefits in respect of one Share. Individuals and their associates are permitted to hold no more than 15% of the lesser of the total number of Units on issue or the total voting rights in the FSF under clause 6.1 of the Unit Trust Deed.

31. The Units in the FSF (including the Fonterra Unit discussed in more detail below, at paragraphs 38 and 39) carry in respect of the FSF a right to vote or participate in any decision-making concerning at least one of the following:

- a dividend or other distribution to be paid or made by the FSF; or
- any variation to the Unit Trust Deed.

32. Clause 4.1(c) of the Unit Trust Deed sets out that the Units do not confer any interest in certain amounts under the Unit Trust Deed, as follows:

> c) Unless the Manager directs otherwise, Units shall not confer any interest in interest income of the Trust. Units shall not confer any interest in monies paid to the Trustee or the Manager to meet their fees or to reimburse either of those parties for (or any advance payment in respect of) any expenses, liabilities, losses and costs incurred by them respectively in or about acting as Trustee or Manager (as the case may be) under this Deed. In all cases, all interest income and such monies will be applied by the Manager to meet the fees and expenses, liabilities, losses and costs incurred by the Manager or the Trustee in or about acting as Manager or Trustee (as the case may be).

33. The FSF Units trade on a registered market (the NZX Main Board and ASX) in which Supplying

Shareholders, RVPs, Fonterra and other Public Investors may participate. Standard listing rules (but with various exemptions to those rules recognising that it is a unit trust and to accommodate other characteristics of Trading Among Farmers) apply to the FSF. Fonterra and the FSF co-operate with each other in relation to matters such as disclosure of information, to enable the FSF to comply with the listing rules applicable to the FSF.

34. Supplying Shareholders, RVPs and Fonterra are able to exchange Units for Shares subject to various limits, but no other investor is able to do this (clause 9 of the Unit Trust Deed). For example, if a Supplying Shareholder, Fonterra or an RVP wished to acquire a Share, it could do so by either buying a Share on the FSM, or by buying a Unit and presenting that Unit to the Unit Trustee for redemption and demanding that the Trustee procure the Custodian to transfer to it (or in the case of the RVP, to the Custodian to hold on trust for the RVP) one Share.

35. Under clauses 6.5 and 7.8 of the Constitution and clause 15.2 of the Unit Trust Deed, neither the RVPs nor the FSF (or the Custodian in relation to either) is entitled to exercise any voting rights attached to Shares which are from time to time held for them by the Custodian (except on an interest group resolution where otherwise no shareholder can vote, clause 24.2(c) of the Constitution).

36. Except as noted in paragraph 34 above, no Unit Holder is entitled or permitted to require the transfer to that Unit Holder of any of the property of the FSF, or any Share. The Unit Trustee covenants that it will not call for a transfer of the Shares (clause 4.8 of the Custody Trust Deed). In addition, no Unit Holder may redeem their Units for cash other than as described in clause 15.1(h) of the Unit Trust Deed. However, Unit Holders may sell their Units to other investors on the NZX Main Board or ASX.

37. In addition to dividends, which are expected to be paid twice a year, other potential distributions in respect of the Shares include:
    - taxable and non-taxable bonus issues;
    - in-specie distributions of property;
    - share buy-backs;
    - dividend reinvestment schemes;
    - renounceable and non-renounceable rights issues; and
    - notional distributions.

38. The Farmer Trustees hold one Unit in the FSF (the Fonterra Unit) which has special, essentially veto, rights (clauses 4.5 to 4.8 of the Unit Trust Deed). This requires the Farmer Trustees' approval, for example, to an amendment, removal or alteration of a provision of the Unit Trust Deed where that amendment, removal or alteration would change:
    - the governance structure of the Board of the Manager;
    - the scope and role of the trust fund;
    - the obligation of the trust to facilitate the exchange of a Share for a Unit or a Unit for a Share; or
    - the limit of 15% on the number of Units that can be held by any person or their associated persons (other than Fonterra or a wholly owned subsidiary of Fonterra); or
    - the terms of the Fonterra Unit.

39. The rights of the Fonterra Unit to proceeds and distributions from the FSF are the same as for all other Units (clause 4.5(h) of the Unit Trust Deed).

40. Section 16 of the Dairy Industry Restructuring Amendment Act 2012 inserted a new s 161A and 161B into the DIRA to allow Fonterra to hold Units in the FSF. Fonterra maintains a unitholding in the FSF which may increase or decrease, but it will always hold at least one Unit. In respect of Units held by Fonterra, the DIRA prevents Fonterra from exercising any voting rights carried by those Units (s 161A(i)).

41. The FSF may derive income other than from the Shares held by the Custodian on its behalf such as interest on cash held in a bank account and amounts received under the Funding Arrangement (Other Income). To the extent the Fund derives Other Income, clause 4.1(c) of the Unit Trust Deed provides that no Unit Holder has an interest in such Other Income, unless the Manager directs otherwise. Any Other Income which is available to the FSF is and will be paid to the Unit Trustee as part of the fees due to the Unit Trustee.

Transitioning to the Financial Markets Conduct Act 2013

42. The FSF will constitute a "managed investment scheme" for the purposes of the Financial Market Conduct Act 2013 (FMCA). The FSF has until 1 December 2016 to meet the requirements of the FMCA. Accordingly, prior to 1 December 2016, various amendments will be made to the Unit Trust Deed in order to comply with the FMCA, and consequential changes will be made to a number of documents including the Authorised Fund Contract. The FSF will no longer be a "unit trust" under the Unit Trusts

Act 1960, as that Act has been repealed (although transitional provisions apply until 1 December 2016).

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The requirements of ss HM 55D(5), (6) and (7), HM 55E, HM 55F and HM 55FB are met in relation to notified foreign investors in the FSF.

b) The FSF is not treated under any double tax agreement as not being resident in New Zealand.

c) The FSF is not in the business of life insurance.

d) 90% or more of the FSF's investments (by value of its assets) are investments of a type referred to in s HM 11, other than an interest in land in New Zealand or a right or option in relation to land in New Zealand, in accordance with s HM 19C(1).

e) 90% or more of the income derived by the FSF is of a type referred to in s HM 12, other than an amount derived from an interest in land in New Zealand or the disposal of an interest in land in New Zealand, in accordance with s HM 19C(2). For the avoidance of doubt, this condition will not be breached if any failure to meet the requirement of s HM 12 is not "significant and within control of the FSF" and is remedied by the last day of the next quarter, in accordance with s HM 25.

f) The FSF has not lost its PIE status through the application of s HM 25, s HM 27 and/or s HM 29.

g) The FSF has not changed its election to use the exit calculation option in s HM 42.

How the Taxation Laws apply to the Arrangement

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

a) The FSF qualifies as a "foreign investment variable-rate PIE" (as defined in s YA 1).

b) The FSF's interest in the Shares is an investment of a type referred to in s HM 11.

c) Income derived by the FSF from its interest in the Shares is income of a type referred to in s HM 12.

d) Income attributed by the FSF to its investors is "excluded income" (as defined in s BD 1(3)) of the investor under s CX 56(3) provided that:

- the prescribed investor rate for the investor is more than zero and not more than the investor's notified investor rate when the PIE calculates its income tax liability under s HM 47, or makes a voluntary payment under s HM 45; or
- the investor is one of those listed in s CX 56(1B); and
- the amount is not an amount of attributed PIE income that is derived by a trustee who has chosen a prescribed investor rate referred to in sch 6, table 1, row 5 or 7, as applicable; and
- the investor is not a new New Zealand resident to whom s HM 57B would have applied but who has chosen not to apply that section to determine their prescribed investor rate for a "resident year" (as defined in s HM 57B(3)).

e) Where a Permitted Person acquires a Share on redemption of a Unit, and is entitled to a deduction under ss DA 1 and/or DB 23, the cost or amount of expenditure incurred in acquiring the Share for the purposes of those sections will be the market value of the redeemed Unit on the day it was redeemed.

f) The redemption of a Unit in the FSF by a Unit Holder, in exchange for a Share, will not give rise to a dividend under ss CD 4 to CD 6.

g) Any distributions from the FSF are excluded income of each Unit Holder under s CX 56B (and therefore not taxable), other than where the FSF elects to pay non-resident withholding tax in accordance with s HM 44B in respect of the distribution.

h) The Arrangement is not subject to s BG 1.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 December 2015 and ending on 31 December 2020.

This Ruling is signed by me on the 21st day of December 2015.

Fiona Heiford

Manager (Taxpayer Rulings)

LEGISLATION AND DETERMINATIONS

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

LIVESTOCK VALUES – 2016 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2015–16 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard cost ("NSC") scheme to value any class of specified livestock.

Farmers using the scheme apply the one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding and rearing rising one-year and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overheads, costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2015 is used while other dairy NSCs are based on the 2014–15 income and expenditure from a DairyBase sample of owner-operated dairy farms. For sheep, beef cattle, deer and goats, NSCs are based on survey data from the 2013–14 sheep and beef farm survey conducted by the Beef & Lamb New Zealand Economic Service. This is the most recent information available for those livestock types at the time the NSCs are calculated in December 2015.

For the 2015–16 income year there has been a decrease in the NSCs for most livestock types (except R1 sheep, dairy cattle, deer and R2 dairy goats). For sheep, beef cattle and fibre and meat producing goats this decrease reflects the decrease, in real expenditure, of costs incurred per livestock unit. A decrease in the costs of foodstuffs is the major component in the decrease in the NSC for both bobby calves and pigs.

The increased NSC for rising one-year sheep reflects a decrease in lambing percentage with costs allocated over fewer lambs than the previous year. For deer the increase reflects the increase, in real expenditure, of costs incurred per livestock unit.

The increased NSCs for rising one- and two-year dairy cattle have come about largely because of a previous change in the calculation methodology. Direct feed/grazing costs are now allocated directly to rising one-year and rising two-year stock, in order to more accurately reflect the actual cost of production. The effect of the resultant change in cost allocation is being phased in over three years, commencing with the NSC determination for the 2013–14 year. This determination sees the full effect of this change in methodology. Adding to the large percentage increase in the NSC value of rising two-year dairy cattle is the effect of an understatement in the NSC of this class of livestock published for the 2014–15 year.

The NSCs calculated each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market

value, the herd scheme and the self-assessed cost scheme ("SAC") option. SAC is calculated on the same basis as NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2016

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2016".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2015–16 income year, where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007 the national standard costs for specified livestock for the 2015–16 income year are as set out in the following table.

National standard costs for 2015–16 income year

Kind of livestock	Category of livestock	National standard cost $
Sheep	Rising 1 year	31.00
	Rising 2 year	21.50
Dairy cattle	Purchased bobby calves	158.50
	Rising 1 year	529.10
	Rising 2 year	414.20
Beef cattle	Rising 1 year	322.80
	Rising 2 year	181.20
	Rising 3 year male non-breeding cattle (all breeds)	181.20
Deer	Rising 1 year	106.00
	Rising 2 year	52.90
Goats (meat and fibre)	Rising 1 year	25.30
	Rising 2 year	17.30
Goats (dairy)	Rising 1 year	174.70
	Rising 2 year	31.40
Pigs	Weaners to 10 weeks of age	103.20
	Growing pigs 10 to 17 weeks of age	86.00

This determination is signed by me on the 20th day of January 2016.

Rob Wells

LTS Manager, Technical Standards

DETERMINATION FDR 2016/01: USE OF FAIR DIVIDEND RATE METHOD FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND

Reference

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

Discussion (which does not form part of the determination)

Shares in the H2O Global Alpha Feeder Fund (Cayman) Limited (the "H2O Feeder Fund"), to which this determination applies, are attributing interests in a foreign investment fund (FIF).

The investments held by the H2O Feeder Fund, a sub-fund of the H2O Global Alpha Master Fund (the "H2O Fund"), are predominantly financial arrangements and interests in it may be hedged back to New Zealand Dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent the investors in the H2O Feeder Fund from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

Despite the H2O Feeder Fund having assets predominantly comprising financial arrangements and the presence of the hedging arrangement, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument. Accordingly, I consider it is appropriate for the investors in the H2O Feeder Fund to use the fair dividend rate method to calculate FIF income from its attributing interest in the H2O Feeder Fund.

Scope of determination

This determination applies to shares held in the H2O Feeder Fund, a sub-fund of the H2O Fund.

The H2O Fund:

- is organised under the laws of the Cayman Islands as a limited liability company;
- is an umbrella, open-ended investment company;
- has variable capital;
- Invests in and trades in equity, fixed income, precious metals, commodities, credit, volatility, international currency and other markets, primarily using derivatives, over-the-counter instruments and foreign exchange forwards.

The H2O Feeder Fund is a sub-fund of the H2O Fund and indirectly invests in the above mentioned markets that H2O Fund invests in.

Interests in the H2O Feeder Fund may be hedged back to New Zealand Dollars.

This determination is made subject to the following conditions:

1. The investment in the H2O Feeder Fund is not part of an overall arrangement that seeks to provide the investor with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.
2. The notional derivative position (being the economic value of derivatives) will be more than 20% of the total asset value of the H2O Fund. If an event occurs that the 20% test is not met, and it is not corrected in 45 days, then this determination ceases to apply from the first day of the following Quarter.
3. The H2O Fund continuously trades in equity, fixed income, precious metals, commodities, credit, volatility, international currency and other markets. If the H2O Fund ceases to do so for a continuous period of 45 days, then this determination ceases to apply from the first day of the following Quarter.

Interpretation

In this determination unless the context otherwise requires:

"H2O Feeder Fund" means the H2O Global Alpha Feeder Fund (Cayman) Limited, which is a sub-fund of the issuer the H2O Global Alpha Master Fund;

"Fair dividend rate method" means the fair dividend method under section YA 1 of the Income Tax Act 2007.

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign Investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Quarter" has the meaning in section YA 1 of the Income Tax Act 2007;

"The investor" means a person who has a share in the H2O Feeder Fund;

Determination

This determination applies to an attributing interest in a FIF, being a direct income interest in the H2O Feeder Fund. This

is a type of attributing interest for which an investor may use the fair dividend rate method to calculate FIF income from that interest.

Application date

This determination applies for the 2017 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for the 2016 income year for an investor in the H2O Feeder Fund unless that investor chooses for this determination to apply for that year.

Dated at Christchurch on 9th day of February 2016.

John Trezise

Investigations Manager, Investigations and Advice

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.

NO JURISDICTION WHERE THE DISPUTES PROCESS HAS NOT BEEN COMPLETED

Case	V Ltd v Commissioner of Inland Revenue
Decision date	17 December 2015
Act(s)	Goods and Services Tax Act 1985, Tax Administration Act 1994
Keywords	Disclosure notice, statement of position, interlocutory, jurisdiction, District Court Rules, Standard Practice Statement

Summary

The disputant sought an order requiring the Commissioner of Inland Revenue ("the Commissioner") to issue a disclosure notice and statement of position with respect to its Notices of Proposed Adjustment ("NOPAs") that were part of a dispute progressing through the disputes process. The Taxation Review Authority ("the Authority") held it is necessary for the disputes process to be completed before challenge proceedings can be filed and so it did not have jurisdiction to hear the application. Further, the jurisdiction of the Authority is found in the Taxation Review Authorities Act 1994, not the District Court Rules 2014. The Authority also found it did not have the power to direct the Commissioner to issue a disclosure notice and she cannot be compelled to do so. While the Standard Practice Statement may set out what is done "generally" or "usually", it is only a guideline and there is no obligation on the Commissioner to follow this course.

Impact

Where there is no assessment or any disputable decision, the disputes process must be completed before a challenge proceeding can be filed.

The Commissioner cannot be compelled to issue a disclosure notice and there is no timeframe in which she must do so.

Facts

V Limited ("the disputant") filed an interlocutory application for an order requiring the Commissioner to file a disclosure notice and a statement of position in response to the disputant's NOPAs dated 22 and 24 July 2015 ("the July NOPAs"). The Commissioner opposed the making of the orders sought.

The Commissioner submitted that the dispute commenced by the July NOPAs was still in the conference stage of the disputes process and therefore the Authority had no jurisdiction to hear and determine the application. She further submitted that the Commissioner could not be compelled to issue a disclosure notice.

The interlocutory application was filed in the context of a challenge proceeding relating to earlier NOPAs issued by the disputant of 1 June 2015 ("the first NOPAs"). The first NOPAs proposed adjustments totalling $138.73 to various GST returns of the disputant. On 3 July 2015, the Commissioner accepted the proposed adjustments and advised the disputant that she was still reviewing the original returns. The Commissioner stated that the accepted adjustments would be reflected in any adjustments made when her review was completed.

On 10 July 2015, the disputant informed the Commissioner that it was disputing the full amount of the original returns and that the Commissioner was required to issue a Notice of Response ("NOR").

On 22 July 2015, the Commissioner replied stating that the dispute commenced by the first NOPAs was at an end because she had accepted the proposed adjustments and consequently it was not necessary to issue a NOR.

The disputant issued the July NOPAs. The NOPAs issued on 22 July 2015 proposed to amend the refunds claimed to only the amounts accepted by the Commissioner in the first NOPAs. The NOPAs issued on 24 July 2015 stated that these NOPAs were issued in substitution for the NOPAs issued on 22 July 2015 which the disputant purported to

withdraw. The 24 July 2015 NOPAs proposed to adjust the original returns to include both the refunds originally claimed and the purported adjustments accepted by the Commissioner.

The Commissioner issued a NOR to the 24 July 2015 NOPAs on 18 September 2015. This was rejected by the disputant on 21 September 2015. By Notice of Claim dated 25 September 2015, the disputant commenced proceedings in the Authority.

Decision

Issue one

The first issue was what was the jurisdiction of the Authority to hear the application.

Under Part 8A of the Tax Administration Act 1994 ("TAA") a disputant is able to challenge assessments and disputable decisions.

The tax positions advanced in the July NOPAs are part of a dispute which is still progressing through the disputes process under Part 4A of the TAA. Presently there is no assessment and nor is there any disputable decision. It is necessary for the disputes process to be completed before a challenge proceeding can be filed. The interlocutory application relates to the July NOPAs which are still subject to the disputes process, and the Authority held it does not have jurisdiction to hear the application.

Issue two

The second issue was whether the Authority could direct the Commissioner to issue a disclosure notice.

The disputant relied upon the District Court Rules 2014 relating to the hearing of interlocutory applications and in particular upon Rule 7.37, which provides that a Judge may make any interlocutory order or grant any interlocutory relief that the Judge thinks just. The disputant submitted that in the circumstances of this case it was just for the Authority to make an order compelling the Commissioner to issue a disclosure notice so that the dispute could be advanced.

Judge Sinclair found that the District Court Rules set out procedures to enable the effective administration of proceedings but did not confer any jurisdiction.

The disputant also referred to the Commissioner's standard practice statement *11/06 Dispute Resolution Process commenced by a taxpayer* ("SPS 11/06") in support of its application, particularly noting paragraphs 248 and 250.

Judge Sinclair found that SPS 11/06 sets out what is done "generally" and "usually". It was clear that there is no obligation on the Commissioner to follow this course and that there will be cases where the timeframe in SPS 11/06 was not followed. Importantly this statement was a guideline only.

No timeframe is specified in s 89M(1) of the TAA within which the disclosure notice has to be issued and the TRA did not have the power to direct that the Commissioner must issue one.

The Authority dismissed the disputant's interlocutory application.

INCONSISTENT TREATMENT CHALLENGE NOT STRUCK OUT

Case	Michael Hill Finance (NZ) Limited v Commissioner of Inland Revenue
Decision date	10 December 2015
Act(s)	Tax Administration Act 1994, High Court Rules 2008
Keywords	Strike out, inconsistent treatment, administrative law, invalidity

Summary

The Michael Hill group of companies entered into a transaction in which it transferred its intellectual property and franchising operations within the group from New Zealand to Australia, using an Australian Limited Partnership ("ALP") as part of the finance structure. Michael Hill Finance (NZ) Ltd ("Michael Hill") owned 95% of the ALP and had applied for a binding ruling on the application of the Income Tax Act 2007, including s BG1, the tax avoidance provision. The Commissioner of Inland Revenue ("the Commissioner") formed the view that s BG1 applied. Michael Hill then amended its ruling application to exclude consideration of s BG1 and self-assessed on the basis that s BG1 applied. It proposed an adjustment to the self-assessment which the Commissioner rejected. Michael Hill then filed challenge proceedings on two grounds—that the Commissioner was inconsistent with her treatment of Michael Hill compared to other taxpayers using the same, or materially the same, ALP structure and the Commissioner's treatment of the transaction is wrong in that it is not tax avoidance. The Commissioner applied to strike out the inconsistency grounds of the challenge. The High Court dismissed the strike-out application.

Impact

Michael Hill's inconsistency challenge will be heard as part of its substantive challenge to the Commissioner's refusal to accept its proposed adjustments. Should Michael Hill's inconsistency challenge ultimately be successful, the

Commissioner may be required to treat materially similarly placed taxpayers consistently, regardless of the correctness of the tax assessment.

Taxpayers may be able to challenge the Commissioner on the basis that they have been treated inconsistently with other taxpayers in materially similar positions. Further, it is possible that the courts may not limit the types of administrative law challenges that may be brought within the Part 8A Tax Administration Act 1994 challenge procedure.

The Commissioner has appealed to the Court of Appeal and, at the date of this issue of the *Tax Information Bulletin*, the appeal is still pending.

Facts

The Commissioner made an application for an order striking out the part of Michael Hill's challenge which alleges that the Commissioner breached a duty to treat taxpayers consistently (the inconsistency challenge).

In December 2008, the Michael Hill group of companies entered into a transaction in which it transferred its intellectual property and franchising operations within the group from New Zealand to Australia. An ALP was used as part of the finance structure. Michael Hill owns 99.5% of the ALP. The ALP was used to create asymmetric tax treatment in the relevant years. The effect of this was that in both New Zealand and Australia there were deductions and that the Australian deduction was not assessable income in New Zealand.

Michael Hill applied for a binding ruling from the Commissioner on the application of the Income Tax Act 2007 ("ITA"), including s BG 1, to the transaction. A binding ruling was provided in relation to the "black letter" tax treatment of the structure, but the Commissioner formed the view that s BG 1 applied.

Michael Hill amended its application for a binding ruling to exclude consideration of s BG 1, and then self-assessed the tax liability on the basis that s BG 1 did apply. Subsequently, Michael Hill proposed an adjustment to its self-assessment. The Commissioner rejected Michael Hill's proposed adjustment by issuing a notice of response.

Michael Hill then initiated challenge proceedings on the following grounds:

1. *An inconsistency challenge:* Michael Hill alleges the Commissioner has taken an inconsistent approach in her treatment of Michael Hill and other taxpayers who have used the same, or materially the same, ALP structures in breach of her duty to treat all similarly placed taxpayers alike.
2. *A correctness challenge:* Michael Hill says the Commissioner's treatment of the transaction is wrong in law in that it is not a tax avoidance arrangement.

The Commissioner accepted the correctness challenge was an orthodox challenge but applied to strike out the inconsistency challenge on the basis it could not stand alone as a valid ground for challenge.

For the purposes of the strike-out application, Toogood J assumed the following facts to be true:

1. There are a number of transactions by other taxpayers that are materially the same as the Michael Hill transaction.
2. Those other transactions have the same tax effects.
3. The Commissioner has, in relation to those other transactions, provided binding rulings that s BG 1 does not apply to certain of them, or made a decision not to investigate certain of them, or investigated certain of the other transactions and formed the view that s BG 1 does not have application to them.

Michael Hill's position

Michael Hill's position was that the inconsistency in treatment should lead to a declaration that the Commissioner has acted unlawfully in rejecting Michael Hill's proposed adjustments, and as a consequence the assessments are unlawful; or that pursuant to s 138P of the Tax Administration Act 1994 ("TAA"), a determination that each of the assessments be cancelled, reduced or modified, or otherwise varied, or a direction that the Commissioner alter each of the assessments in a way that conforms with the Court's determination.

The Commissioner's position

The Commissioner's position was that the inconsistency challenge is a collateral attack on assessments, which is untenable and unarguable because there is no basis in law to adjust an otherwise correct assessment on the grounds of inconsistent treatment as between taxpayers; the Court will determine the correctness of the assessments in issue by way of a de novo hearing that is curative of any defects; and the inconsistency challenge does not fall within the narrow category of cases that would not turn on correctness.

Decision

Issue one

The first issue was whether there was an arguable case that the Commissioner has an enforceable duty to act consistently.

Toogood J was not persuaded that Michael Hill's position was inarguable. It was, he said, consistent with the

treatment of the consistency principle in New Zealand case law and also academic opinion.

As Toogood J read the case law, there are essentially two questions to be answered when a claim of inconsistency is made against the Commissioner:

1. First, are the facts or circumstances identical for all material purposes, such that there is a true inconsistency because the assessments or rulings at issue cannot be reconciled as a matter of law?
2. Second, if there appears to have been inconsistent treatment, is the discrepancy explicable and not unfair?

Issue two

The second issue was whether the facts of the challenge make it untenable that Michael Hill could succeed in enforcing such any such duty.

Toogood J found that, on the current pleadings, the pleaded facts (which for the purposes of the strike-out application are assumed to be provable) did not render the inconsistency argument untenable.

Issue three

The third issue was whether ss 109 and 114 of the TAA prevent a taxpayer from raising administrative law grounds in challenge proceedings except in "exceptional circumstances".

The Commissioner argued that the effect of ss 109 and 114 of the TAA, and the decision of the Supreme Court in *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158 ("*Tannadyce*"), was to limit the ability of a taxpayer to raise administrative law grounds in challenge proceedings other than in "exceptional circumstances", and that *Tannadyce* cannot be said to have expanded the Court of Appeal decision in *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24 ("*Westpac*").

Toogood J found that it was distinctly arguable that the test in *Westpac* was not the test that determines whether an invalidity challenge is properly brought within Part 8A of the TAA, and that in any event the majority in *Tannadyce* appeared to have overruled the test in *Westpac*.

It was at least arguable that the Supreme Court's decision in *Tannadyce* allowed Michael Hill to bring a challenge under Part 8A of the TAA on inconsistency grounds. It was arguable that there are no limitations on the types of administrative law challenges that may be brought within the Part 8A procedure.

Issue four

The fourth issue was, in challenge proceedings, whether a finding that the Commissioner's decision was correct trumps any invalidity which might otherwise result from a breach of the duty of inconsistency.

Toogood J found it was arguable that a taxpayer was not prevented from raising administrative law grounds of challenge despite a claim by the Commissioner that the correctness of the decision remedies any invalidity resulting from the decision-making process.

Issue five

The fifth issue was whether the inconsistency challenge should be struck out.

On the basis of his conclusions for issues one through four, Toogood J did not consider it plain and obvious that Michael Hill's inconsistency challenge could not succeed, and dismissed the Commissioner's application to strike it out. He also awarded costs to Michael Hill on a category 2B basis, plus disbursements.

The Commissioner has appealed the decision and at the date of this *Tax Information Bulletin*, the appeal is still pending.

LIABILITY FOR PAYE: WERE THE SHARES HELD ON BARE TRUST?

Case	TRA 022/14 [2015] NZTRA 22
Decision date	17 December 2015
Act(s)	Income Tax Act
Keywords	PAYE, bare trusts, shareholding, s RD 3, s YB 21

Summary

This case was about whether the disputant was liable to pay PAYE on monthly payments made to Mr X. The disputant argued that Mr X was a shareholder of the disputant and therefore the disputant was not required to return the PAYE owing as the monthly payments were not PAYE income payments to Mr X. Deciding whether MR X was a shareholder of the disputant turned on whether Mr A (sole registered shareholder of the disputant) held shares in the disputant for Mr X on bare trust.

Impact

In determining whether a bare trust exists, the Taxation Review Authority ("the Authority") looked into the powers and obligations of the person who claimed to be a bare trustee. In this case, Mr A's powers to transfer the property exceeded those of a bare trustee. Mr A also did not

consider himself to be under any obligation to transfer the property when asked to do so.

Facts

The Commissioner of Inland Revenue ("the Commissioner") assessed the disputant for PAYE for 38 periods between February 2007 and March 2010 on the basis that the disputant failed to account to the Commissioner for PAYE from monthly payments ("the Monthly Payments") made to Mr X.

The disputant contended that the Monthly Payments were not subject to PAYE as Mr X was a shareholder-employee. Mr X was not a registered shareholder of the disputant (Mr A was the registered shareholder of all the shares). However, the disputant asserted that Mr X held a 30% shareholding with the disputant as a beneficiary by way of a bare trust arrangement, with Mr A holding the shares on a bare trust.

Decision

The two issues for determination by the Authority were whether Mr A held the shares as a bare trustee on trust for Mr X and, if so, whether the Monthly Payments made to Mr X were excluded from being taxable under s RD 3(2) of the Income Tax Act ("ITA").

There was no dispute between the parties as to the relevant law.

Section RA 5 of the ITA requires employers to withhold tax and pay PAYE. Section RD 3(1)(b)(ii) provides that the PAYE rules apply to a PAYE income payment which does not include an amount to a shareholder-employee in the circumstances set out in s RD3(2). Section YB 21(1) of the ITA states that if a person holds or does something as a nominee for another, the other person is to be treated as holding or doing that thing and the nominee is ignored. Section YB 21(2) of the ITA provides that a trustee is only a nominee if the trustee is a bare trustee.

Judge Sinclair, in considering the meaning of a bare trustee, referred to *Halsbury's Law of England* (5th ed, vol 98 at 195) which stated:

> ... A bare trustee has been defined as a person who has himself no present beneficial interest in it and no duties to perform in respect of it except to convey and transfer it to persons entitled to hold it, and he is bound to convey or transfer the property accordingly when required to do so.

She also referred to *Hedergen v Federal Commissioner of Taxation* (1998) 84 ALR 271 at 281, in which Gummow J distinguished between passive and active trusts and *Burns v Steel* [2006] 1 NZLR 559 at [62], in which Randerson J observed that it is not enough that the description of "bare trustee" is used.

Judge Sinclair moved on to consider the requirements to create a valid express trust: certainty of intention, certainty of subject matter and certainty of object.

Issue 1: Were the shares held in the disputant pursuant to a bare trust?

Judge Sinclair first considered the Deed of Declaration of Trust dated 21 December 2006 that Mr A executed and which provided:

> The Trustee shall at all times deal with all matters at the direction of [Mr A] and shall when called upon or when the Trustee so wishes whichever shall be the earlier transfer the shareholding of the Company ...

Judge Sinclair found that Mr A as trustee was not acting simply as a bare trustee for Mr X but had powers to transfer the property which exceeded those of a bare trustee. Mr A as trustee had power to "deal with all matters" at the direction of himself and retained the power to transfer the shares at his own discretion without any demand from the beneficiaries.

Judge Sinclair noted that the Deed of Trust referred to the disputant as "to be incorporated" and then considered the issue around "certainty of subject matter". The shares described in the Deed of Trust were B class shares but the shares issued by the disputant were all ordinary shares. Judge Sinclair did not consider that it can be said that the shares described in the Deed of Trust are clearly identifiable as those subsequently issued by the disputant.

Judge Sinclair also referred to Mr A's evidence that Mr X gave valuable consideration for the creation of the trust and the submissions that the Deed of Trust formed part of the consideration (which was described as being part of the oral agreement reached by Mr A and Mr X in 2006). Judge Sinclair was not satisfied that there was any oral agreement pursuant to which Mr X waived his rights under a Heads of Agreement dated 9 January 2006 and noted that there is no evidence that Mr X agreed to the shares being held on trust or had knowledge of the existence of the Deed of Trust.

Judge Sinclair did not accept the disputant's contention that while Mr A had been in breach of his duty as trustee in not transferring the shares, this did not mean that he was not holding the shares as a bare trustee pursuant to the Deed of Trust, and found that Mr A is not a bare trustee under the Deed of Trust or, in the alternative, the Deed of Trust is not valid and enforceable.

Having considered the communication between Mr A, Mr X and their advisors and Mr A's affidavit (sworn on

25 January 2011 in support of a notice of opposition to Mr X's originating application to rectify the share register) in which Mr A states that the transfer was conditional on an appropriate mechanism being finalised dealing with the control of the companies and protection of the shareholders, the Authority was not satisfied that Mr A held the shares on trust for Mr X as a bare trustee.

As Mr A was not holding the shares in the disputant as a bare trustee, s YB21 of the ITA cannot apply to deem Mr X to be a shareholder of the disputant. As a result, the amounts paid to Mr X were PAYE income payments under s RD 3(2)(b)(ii).

As Judge Sinclair found that Mr A was not holding the shares as a bare trust, it was not necessary to consider the second issue.

The Authority dismissed the challenge and confirmed the Commissioner's assessments.

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