

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 |
|---------|--|--|------------------|
| IRRUIP9 | Draft issues paper Donee organisations - clarifying when funds are applied wholly or mainly to specified purposes within New Zealand | This issues paper foreshadows a possible change in Inland Revenue's current practice for donee organisations. It examines the "donee organisation" requirements of the Income Tax Act 2007, and is particularly relevant to organisations that apply some of their funds to purposes outside of New Zealand. | 24 June 2016 |

IN SUMMARY

Binding rulings

Public Rulings BR Pub 16/05: Income tax - treatment of a subdivision of shares under section CB 4 and BR Pub 16/06: Income tax - treatment of a disposal of subdivided shares under section CB 4

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These rulings are reissues of BR Pub 13/01 and BR Pub 13/02, which expired on 20 May 2016. The original rulings considered the treatment of a subdivision of shares and a disposal of subdivided shares (where the original shares were acquired for the purpose of disposal) under s CB 4. The central technical issue considered was whether subdivided shares are treated as the same or different property from the original shares. The conclusion was that they are the same.

Legislation and determinations

National average market values of specified livestock determination 2016

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This determination sets the national average market values to apply to specified livestock on hand at the end of the 2015-2016 income year.

CPI Adjustment 16/01 for Determination DET 09/02: Standard-cost household service for childcare providers

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Inland Revenue advises that, for the 2016 income year, the variable standard-cost component and the administration and record-keeping fixed standard-cost components have been adjusted.

CPI Adjustment 16/02 for Determination DET 05/03: Standard-cost household service for boarding service providers

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Inland Revenue advises that the weekly standard-cost component for the 2016 income year has been adjusted.

Operational statements

CS 16/01: Commissioner's statement: OECD information sharing requirements for taxpayer rulings and determinations

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This item informs taxpayers of the new OECD requirements to exchange certain cross-border taxpayer rulings and determinations with other OECD countries. It explains which rulings will be subject to the exchange requirements and the process that will be followed by the Commissioner.

2016 review of the Commissioner's mileage rate for expenditure incurred for the business use of a motor vehicle

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Inland Revenue has concluded a review of the Commissioner's mileage rate and advises the rate for the 2016 income year results in a reduction to the rate to 72 cents (from 74 cents for 2015) per kilometre for both petrol and diesel fuel vehicles.

Questions we've been asked

QB 16/03: Goods and services tax - GST treatment of bare trusts

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This "Question we've been asked" considers whether it is the trustee or the beneficiary of a bare trust who makes supplies in respect of the trust property for GST purposes. It concludes that, based on agency principles and case law, any taxable activity is carried on by the beneficiary, rather than the bare trustee. Therefore, it is the beneficiary of a bare trust who makes and receives supplies in respect of the trust property for GST purposes.

Legal decisions - case notes

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High Court finds for Commissioner on tax avoidance and imposes an abusive tax position shortfall penalty

Tale Holdings Limited ("Tale") entered into an arrangement to purchase a property development ("Delta") from Te Anau Lakeside Estates Limited ("Te Anau") facing liquidation action. Under the arrangement the purchase price was set according to the amount owed under Te Anau's mortgage. Tale took the property subject to the mortgage and paid no money to Te Anau. Tale claimed a goods and services tax ("GST") input tax deduction for the tax fraction of the purchase price and Te Anau did not pay any GST output tax. The Court held that:

- Tale was engaged in an arrangement that had a tax avoidance purpose or effect that was not merely incidental;
- The Commissioner of Inland Revenue ("the Commissioner") was correct to disallow the whole of the GST refund sought by Tale; and
- The Commissioner's assessment of a shortfall penalty was correct.

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 (IR715)*. You can download this publication free from our website at www.ird.govt.nz

① This is a reissue of BR Pub 13/01 and BR Pub 13/02. For more information about earlier publications of these Public Rulings see the Commentary to this Ruling.

INCOME TAX - TREATMENT OF A SUBDIVISION OF SHARES UNDER SECTION CB 4

PUBLIC RULING - BR PUB 16/05

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

Taxation Laws

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

This Public Ruling is about how s CB 4 applies to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a company subdivides all of its shares and the following factors apply:

- The directors resolve that all of the shares in the company will be subdivided so that each share splits into an equal number of shares.
- The rights attaching to the shares will continue in existence throughout the subdivision process and will not be altered.
- Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders.
- The subdivision will merely represent the reformatting of each shareholder's interest.

The Arrangement does not include situations where the rights of the shares are varied.

For the avoidance of doubt, the Arrangement does not include arrangements where s BG 1 of the Act applies to void the arrangement.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The subdivision of shares does not result in a disposal of personal property for the purposes of s CB 4.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 21 May 2016.

This Ruling is signed by me on 26 April 2016.

Susan Price

Director, Public Rulings

INCOME TAX - TREATMENT OF A DISPOSAL OF SUBDIVIDED SHARES UNDER SECTION CB 4

PUBLIC RULING - BR PUB 16/06

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

Taxation Laws

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

This Public Ruling is about how ss CB 4 and ED 1 apply to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a shareholder holds shares in a company and those shares were acquired for the purpose of disposal. The company then subdivides its shares and the following apply:

- The directors resolve that all of the shares in the company will be subdivided so that each share splits into an equal number of shares.
- The rights attaching to the shares will continue in existence throughout the subdivision process and will not be altered.
- Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders.
- The subdivision will merely represent the reformatting of each shareholder's interest.

After the subdivision, the shareholder disposes of some or all of their subdivided shares.

The Arrangement does not include situations where the rights of the shares are varied.

For the avoidance of doubt, the Arrangement does not include arrangements where s BG 1 of the Act applies to void the arrangement.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Section CB 4 applies to the disposal of the subdivided shares.
- The time of acquisition of a subdivided share held on revenue account is the time the original share (which was subdivided) was acquired.
- Under s ED 1, the cost of each subdivided share can be determined by dividing the cost of an original share equally between its subdivided shares.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 21 May 2016.

This Ruling is signed by me on 26 April 2016.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 16/05 AND BR PUB 16/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 16/05 and BR Pub 16/06 (the Rulings).

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

Summary

1. In the circumstances set out in the Rulings, a subdivision of shares does not result in a disposal of any shares for the purposes of s CB 4. This is because when a company subdivides shares, the original shares are not cancelled and the shareholders' rights are not altered or terminated by the subdivision.
2. When a shareholder who acquired the original shares on revenue account disposes of a subdivided share, s CB 4 will apply to the disposal. This is because the subdivided shares are the same property as the original shares acquired. Therefore, the time of acquisition of the subdivided shares is the time of acquisition of the original shares. Under s ED 1, a reasonable method to determine the cost of each subdivided share is to divide the cost of an original share equally between its subdivided shares.

Background

3. The Rulings are reissues of BR Pub 13/01 and BR Pub 13/02, which expire on 20 May 2016. BR Pub 13/01 and BR Pub 13/02 were published in *Tax Information Bulletin* Vol 25, No 6 (July 2013): 26 and applied for the period beginning on 21 May 2013 and ending on 20 May 2016. The Rulings are essentially the same as BR Pub 13/01 and BR Pub 13/02.
4. A subdivision of shares is variously known as a "share split", a "share subdivision", or as a type of "share reorganisation". One reason that a company might undertake a subdivision of shares is to improve the marketability of that company's shares.
5. There are at least three ways to achieve an increase in the amount of shares in a company for no additional consideration, described as a subdivision of shares, namely:
 - existing shares can be cancelled or redeemed and, for no additional consideration, a greater number of shares can be issued to all shareholders in the same proportion as their original shareholdings;
 - in addition to the original shares, shares can be issued for no additional consideration to all

shareholders in the same proportion as the shares already held;

- existing shares can be converted into a greater number of shares for no consideration.
6. The Rulings are concerned with only the third type of subdivision of shares.
 7. Section CB 4 provides that an amount derived on the disposal of personal property acquired for the purpose of disposal is income of the person. A share is a type of personal property: s 35 of the Companies Act 1993 (CA 1993). Therefore, in this context, questions arise on the application of s CB 4 to a subdivision of shares and to the disposal of a subdivided share.

Application of the legislation

8. The Rulings consider two situations. These situations represent two points in time at which s CB 4 could apply to subdivided shares, namely when the:
 - shares are subdivided;
 - subdivided shares are disposed of.
9. Whether s CB 4 applies in these situations depends on whether the subdivided shares can be regarded as the same property as the original shares.

Can the subdivided shares be regarded as the same property as the original shares?

10. Two broad requirements of s CB 4 must be satisfied. If these requirements are met, an amount that the person derives from disposing of the personal property is income of the person. The first requirement is that a person acquires personal property for the purpose of disposing of it. The second requirement is that the person disposes of the personal property.
11. The grammatical construction of s CB 4 shows that the property disposed of must be the same property as that acquired. When a subdivided share is disposed of, the question then arises whether the subdivided shares are the same property as the original shares. The answer to this question will also assist in determining the time of acquisition of the subdivided shares for the purposes of s CB 4.
12. In determining whether the subdivided shares are the same property as the original shares, it is helpful to consider:
 - What is the nature of a share?
 - Does a subdivision of shares involve an issue of shares?
 - Have the original shares been disposed of or cancelled?

- Have the shareholders' rights changed as a result of the subdivision of shares?
- Does the Act provide any guidance?

What is the nature of a share?

13. It is generally accepted that a share is a bundle of rights and obligations conferred under a contract between the shareholders and the company: *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279; *Bradbury v English Sewing Cotton Ltd* [1923] AC 744 (HL); *IR Commrs v Laird Group plc* [2003] UKHL 54. This was confirmed by the New Zealand Court of Appeal in *Robertson v Bicknell* [2002] BCL 408 (CA). In *Robertson*, the court also confirmed that the nature of the property in a share is the interest of a person in the company, that interest being comprised of various rights and obligations (at [23]).
14. The CA 1993 and the general law on shares suggest that shares are an "aliquot" (meaning a portion of a larger whole) interest in a company; that is, a bundle of rights and obligations representing the shareholder's proportionate interest in the company. The removal of par and nominal values for shares under the CA 1993 reinforces this approach.
15. Section 35 of the CA 1993 provides that a share in a company is personal property. In addition, s 36 of the CA 1993 sets out the basic rights and powers that attach to shares. These basic rights and powers include the right for the shareholder to vote at a meeting of the company on any resolution, the right to an equal share in dividends authorised by the board, and the right to an equal share in the distribution of surplus assets of the company. It is important to note that the rights and powers conferred by this section may be negated, altered or added to by the constitution of the company. Therefore, in any given situation, the constitution of a company (if it has one) will be an important factor in determining the nature of a share and the rights and powers attached to it.

Does a subdivision of shares involve an issue of shares?

16. If a subdivision of shares involves an issue of new shares, this may indicate that subdivided shares are different property from the original shares. Sections 41 to 51 of the CA 1993 provide rules on issuing shares. However, the CA 1993 does not provide any guidance about how to achieve a subdivision of shares. There is only one reference in the CA 1993 to subdivisions of shares and that is in s 48. Section 48 is an exception to the requirements in s 47 of the CA 1993, which apply to the issuing of shares by a company after

its registration. One view is that this shows that a subdivision must involve an issue of shares - otherwise there would be no need for the express exclusion. The other view is that the exclusion was simply to avoid any doubt in this regard. Apart from this, the CA 1993 is silent about how subdivisions should be effected. It is difficult, therefore, to draw an inference from the CA 1993 on whether a subdivision of shares involves an issue of new shares. In practice, a company's annual return is the method by which the Companies Register is updated to reflect changes in the number of shares held and by whom.

17. By comparison, the Companies Act 1955 (CA 1955) did include a procedure for the subdivision of shares. Sections 70 and 71 of the CA 1955 allowed a company to alter the conditions of its memorandum to, among other things, "subdivide its shares ... into shares of smaller amount" and required the company to notify the Registrar. This process was a separate one from that required to issue shares: see, for example, ss 14, 60, 70(1)(a), 72 and reg 2, Table A, Sch 3. This suggested that subdivisions of shares did not involve an issue of shares.
18. It has been suggested that the issue of shares involves the creation of property: *FCT v St Helens Farm (ACT) Pty Ltd* (1981) 146 CLR 336. Cases on the issue of shares support the view that a subdivision of shares does not involve an issue of shares. The thrust of these cases is that an issue of shares involves something leaving the company and being provided to the shareholder: *Central Piggery Co Ltd v McNicoll* (1949) 78 CLR 594; *National Westminster Bank plc v IR Commrs* [1995] 1 AC 119 (HL). The Commissioner considers that, in the case of a subdivision of shares, nothing has left the company or been provided to the shareholder. The shareholder has the same bundle of rights before and after the subdivision.
19. The CA 1955 suggested that subdivisions of shares did not involve an issue of shares. As noted, there is no clear process for subdivisions of shares under the CA 1993, but there is also no indication that the CA 1993 was intended to change the position under the CA 1955 for subdivisions of shares. Given that the case law shows that an issue of shares involves something being provided by the company to the shareholder, it seems that a subdivision of shares does not involve an issue of shares. Therefore, the Commissioner considers the better view is that subdivisions of shares do not involve an issue of shares.

Have the original shares been disposed of or cancelled?

20. "Dispose" is not defined in s YA 1 for the purposes of s CB 4. (It is defined for the purposes of other sections in the Act, but these definitions do not assist in this inquiry.) The courts have held that "disposal" means the property is "got rid of" and is no longer in the control or possession of the disposer in any capacity: *FCT v Wade* (1951) 84 CLR 105; *Lyttelton Port Co Ltd v CIR* (1996) 17 NZTC 12,556 (HC); *Coles Myer Ltd v Commissioner of State Revenue (VIC)* (1998) ATC 4,537 (VICCA). As a result, the Commissioner considers that a "disposition" and/or "disposing" of property must involve the transfer or alienation of that property by the disposer.
21. Further, the provisions in the CA 1993 dealing with the cancellation of shares do not expressly apply to share subdivisions. This suggests that a subdivision does not involve the cancellation of the shares being subdivided. In addition, the case law shows that a "disposition" and/or "disposing" of property must involve total alienation of that property by the disposer. The absence of the cancellation of the existing shares and the fact the shareholder's interests in the company are never alienated on a subdivision of shares suggests the original shares continue in existence.
22. In addition, when a company subdivides all the shares in the company, the shareholders retain control of their proportionate shares in the company.

Have the shareholders' rights changed as a result of a subdivision of shares?

23. As noted above, the basic rights attaching to a share (under the CA 1993) include the right to vote, the right to an equal share in dividends and the right to an equal share in the distribution of surplus assets. It might be argued that a subdivision of shares involves changes to a shareholder's rights in some way because, for example, the number of votes held by the shareholder may increase in nominal terms. However, if this is viewed in terms of a share being a bundle of rights, then nothing has changed. The proportionate interest (and rights) that the shareholder had before and after the subdivision of shares remains the same. Said another way, the shareholder has, for example, a greater number of votes but the same proportionate voting interest in the company. Therefore, the Commissioner considers a subdivision of shares has little effect on shareholders' rights - the subdivision results in more shares, but the shareholders' proportionate interest in the company does not change.

24. The cases on subdivisions of shares in other legal contexts generally take the view that a subdivision of shares does not give rise to new property: *Whittome v Whittome (No 1)* (1994) SLT 114 (OH); *Greenhalgh v Arderne Cinemas Ltd* [1946] 1 All ER 512 (CA). There is also a suggestion that the subdivided shares could be traced back to, and identified with, the original shares: *In re Financial Corp* (1866-67) LR 2 Ch App 714. In addition, in cases concerned with whether a bequest of shares has "adeemed", the question is whether the property exists as substantially the same thing at the death of the testator. (A gift will "adeem" - that is, be extinguished - in circumstances where, for example, there is a change in the nature of the gift between the time the testator makes the will and the testator's death.) In several cases it has been accepted that subdivided shares have been changed in name and form only, but are substantially the same thing as the original shares: *Re Greenberry, Hops v Daniell* (1911) 55 Sol J 633; *In re Faris, Goddard v Overend* [1911] 1 IR 165 (IrHC); *In re Clifford, Mallam v McFie* [1912] 1 Ch 29; *Guardian Trust and Executors Co of NZ Ltd v Smith* [1923] NZLR 1,284 (SC).
25. Some support for the view that subdivided shares are the same property as the original shares may also be taken from cases on "identity of property". These cases show that where the legal rights acquired are different in nature from those sold, then the property could not be considered to be the same property: *McClelland v FCT* (1970) 120 CLR 487 (PC); *AL Hamblin Equipment Pty Ltd v FCT* 74 ATC 4,310 (HCA). However, cases on "identity of property" also suggest that a mere subdivision of land does not change the nature of the legal rights in the property: *Moruben Gardens Pty Ltd v FCT* 72 ATC 4,147 (HCA). In that case, Mason J regarded the sale of all of the subdivided units as constituting a disposition of the entire estate in fee simple. He concluded that there was identity of property before and after the subdivision because the nature of the legal rights in the property remained the same.

Does the Act provide any guidance?

26. Little guidance can be gained directly from the Act. Only s EX 68 deals with subdivisions of shares directly (this section uses the term "share split"). The wording of this section might suggest that a new interest arises. However, on balance, the Commissioner does not think this is the case. The wording of this section reflects the need to ensure the formulae in the foreign investment fund rules work when the number of shares in a foreign investment fund has increased without any new value being introduced.

27. The amendments made to the definition of "bonus issue" by the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013 clarified that subdivisions of shares are excluded from the dividend rules. The Rulings consider whether s CB 4 applies to subdivisions of shares and the disposal of subdivided shares. The amendments did not affect the reasoning and conclusions in the Rulings.

Conclusion

28. In summary, under the CA 1993, it appears that a subdivision of shares in the circumstances set out in the Rulings does not involve an issue of new shares or the cancellation of the original shares - the original shares are merely reformatted or reorganised. Overall, the Commissioner considers that, when shares are subdivided, the shareholder's rights in the company have not changed, even though the form in which those rights are held has changed. As a result, the Commissioner considers that the subdivided shares are the same property as the original shares for the purposes of s CB 4.

Does s CB 4 apply at the time the shares are subdivided?

29. When a company subdivides shares, the Commissioner considers that at no point does the shareholder give up or lose their share rights as a result of the subdivision. The Commissioner considers that support for this view can be found in *Whittome*. In that case, the court considered a subdivision did not affect the identity of the property held by the shareholders, nor did it affect the proportion of the ownership held by the shareholders. The court considered that the shares were not affected by the subdivision and the shares held following the subdivision were the same property as the shares held before the subdivision.
30. Given this, the Commissioner considers s CB 4 does not apply at the time a person's shares are subdivided.

Does s CB 4 apply at the time subdivided shares are disposed of?

31. An amount derived by a person on the disposal of subdivided shares, where the original shares were acquired for the purpose of disposal, will be income of the person under s CB 4. Conversely, s CB 4 will not apply to an amount derived by a person on the disposal of subdivided shares where the original shares were not acquired for the purpose of disposal. This is because the shares held by the person after a subdivision are the same property as the shares held by the person before the subdivision.

What is the time of acquisition and cost base of subdivided shares held on revenue account?

32. Given that subdivided shares are the same property as the original shares, the Commissioner considers that the time of acquisition of the subdivided shares is the time the original shares were acquired.
33. The cost of the original shares may be used to determine the cost base of the subdivided shares held on revenue account for s ED 1.
34. The Commissioner considers that a reasonable method to determine the cost of a subdivided share is to divide the cost of an original share equally between its subdivided shares.

Examples

35. The following examples are included to help explain the application of the law.

Example 1 - shares acquired for the purpose of disposal

36. On 21 July 2013, Matiu purchased 500 shares in Barry's Bananas Ltd (BBL) for \$10 per share. On 10 January 2014, Matiu purchased another 500 shares in BBL for \$15 per share. BBL has one class of shares with 100,000 shares on issue. Matiu acquired his 1,000 shares for the purpose of disposing of them at a profit in the future. Therefore, Matiu holds these shares on revenue account.
37. The directors of BBL decide to subdivide all the shares in BBL so that there will be 400,000 shares on issue. The directors pass a resolution stating:
- The Board resolves to subdivide (for nil consideration) each Share in the Company into four Shares of the same type. The subdivision of the Company's Shares will take effect on 1 May 2014.
38. The rights attaching to BBL's shares will continue in existence throughout the subdivision process and will not be altered. Each shareholder's proportionate shareholding in the company will remain the same relative to the other shareholders. In addition, the subdivision will merely represent the reformatting of each shareholder's interest.
39. When the subdivision takes place, BBL's share register is updated with the new numbers of shares. BBL also informs the Companies Office of the subdivision and the new number of shares is recorded on the Companies Register.
40. After the shares are subdivided, Matiu has 4,000 shares. However, Matiu still has the same proportionate interest in the company and the same rights under the shares as he did before the subdivision. In addition, at no point during the

subdivision did Matiu not hold shares in BBL.

Therefore, s CB 4 will not apply at this time because Matiu has not disposed of anything

41. On 18 May 2014, Matiu sells his 4,000 shares to Wiremu for \$5 per share. Matiu receives \$20,000 from Wiremu in return for the shares. At this point, the requirements of s CB 4 have been met; that is, Matiu has derived an amount from the disposal of property that he acquired for the purpose of disposal. As a result, Matiu will have derived an amount of income on the sale of the shares. Matiu does not acquire or dispose of any more shares in BBL in 2014.
42. The cost base of the subdivided shares is the cost of each of the original shares divided equally among its subdivided shares. That is, the cost of each original share is divided equally across four subdivided shares.
43. Matiu acquired 500 shares before the subdivision for \$10 per share. After the subdivision those 500 shares became 2,000 shares. As a result, the cost per share of each of those subdivided shares is \$2.50.
44. Matiu also acquired a further 500 shares before the subdivision for \$15 per share. After the subdivision those 500 shares became 2,000 shares. The cost per share of each of those subdivided shares is \$3.75.
45. In the 2014-15 income year, the amount that Matiu derives on the disposal of the shares will be income. In addition, the opening value of the shares (ie, the cost of the shares) will be allowed as a deduction under the matching rules in s ED 1. Using the cost bases identified above, this is calculated in the following way:
 - The acquisition cost of the subdivided shares is \$5,000 for the first 500 shares acquired, and \$7,500 for the second 500 shares acquired. This gives a total acquisition cost for the 4,000 shares of \$12,500.
 - Matiu sold all 4,000 shares to Wiremu for \$20,000.
 - The profit of \$7,500 that Matiu derived from the sale of the shares will form part of Matiu's net income.

Example 2 - shares not acquired for purpose of disposal

46. On 18 February 2014, Wei purchased 50 shares in BBL. Wei bought the shares as a long-term investment to earn dividends for his family. On 20 March 2014, BBL announces that it will subdivide its shares. After the subdivision, Wei will have 200 shares. Soon after, Wei is diagnosed with a serious illness. He decides to sell some of his shares to help pay for his treatment.
47. BBL subdivides its shares on 1 May 2014. On 2 May 2014, Wei sells 125 of his shares to Gareth. In this situation, s CB 4 will not apply to the amount that Wei derives on the disposal of the 125 shares. This is because, at the time Wei acquired the shares (on 18 February 2014), he did not acquire the shares for the purpose of disposal.

References

| Expired Rulings |
|---|
| BR Pub 13/01 "Income tax - Treatment of a subdivision of shares under section CB 4" and BR Pub 13/02 "Income tax - Treatment of a disposal of subdivided shares under section CB 4", <i>Tax Information Bulletin</i> Vol 25, No 6 (July 2013): 26 |
| Subject references |
| Cancellation of shares |
| Disposal |
| Issue of shares |
| Personal property |
| Subdivision of shares |
| Legislative references |
| Companies Act 1993, ss 35, 48 |
| Income Tax Act 2007, ss CB 4, ED 1, EX 68 |

| Case references |
|--|
| <i>AL Hamblin Equipment Pty Ltd v FCT</i> 74 ATC 4,310 (HCA) |
| <i>Borland's Trustee v Steel Brothers & Co Ltd</i> [1901] 1 Ch 279 |
| <i>Bradbury v English Sewing Cotton Ltd</i> [1923] AC 744 (HL) |
| <i>Central Piggery Co Ltd v McNicoll</i> (1949) 78 CLR 594 |
| <i>Clifford, In re, Mallam v McFie</i> [1912] 1 Ch 29 |
| <i>Coles Myer Ltd v Commissioner of State Revenue (VIC)</i> (1998) ATC 4,537 (VICCA) |
| <i>Faris, In re, Goddard v Overend</i> [1911] 1 IR 165 (IrHC) |
| <i>FCT v St Helens Farm (ACT) Pty Ltd</i> (1981) 146 CLR 336 |
| <i>FCT v Wade</i> (1951) 84 CLR 105 |
| <i>Financial Corp, In re</i> (1866-67) LR 2 Ch App 714 |
| <i>Greenberry, Re, Hops v Daniell</i> (1911) 55 Sol J 633 |
| <i>Greenhalgh v Arderne Cinemas Ltd</i> [1946] 1 All ER 512 (CA) |
| <i>Guardian Trust and Executors Co of NZ Ltd v Smith</i> [1923] NZLR 1,284 (SC) |
| <i>IR Commrs v Laird Group plc</i> [2003] UKHL 54 |
| <i>Lyttelton Port Co Ltd v CIR</i> (1996) 17 NZTC 12,556 (HC) |
| <i>McClelland v FCT</i> (1970) 120 CLR 487 (PC) |
| <i>Moruben Gardens Pty Ltd v FCT</i> 72 ATC 4,147 (HCA) |
| <i>National Westminster Bank plc v IR Commrs</i> [1995] 1 AC 119 (HL) |
| <i>Robertson v Bicknell</i> [2002] BCL 408 (CA) |
| <i>Whittome v Whittome (No 1)</i> (1994) SLT 114 (OH) |

APPENDIX – LEGISLATION

Income Tax Act 2007

1. Section CB 4 provides:

CB 4 Personal property acquired for purpose of disposal

An amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it.

2. Section ED 1 relevantly provides:

ED 1 Valuation of excepted financial arrangements

Valuation methods for excepted financial arrangements

- (1) A person who has revenue account property that is an excepted financial arrangement must determine the value of the arrangement at the end of each income year at cost.

...

Cost-flow methods

- (5) The person must use 1 of the following cost-flow methods to allocate costs:
- (a) the first-in first-out cost method; or
 - (b) the weighted average cost method.

...

Persons complying with generally accepted accounting practice

- (6) A person who complies with generally accepted accounting practice must comply with the consistency and disclosure requirements of NZIAS 8 or an equivalent standard issued in its place.

Other persons

- (7) A person who does not comply with generally accepted accounting practice—
- (a) must be consistent from 1 income year to the next in their choice of 1 of the cost-flow methods described in subsection (5); and
 - (b) may change their cost-flow method if—
 - (i) the change is justified by sound commercial reasons and for this purpose, the advancement, deferral, or reduction of an income tax liability is not a sound commercial reason; or
 - (ii) the change is required by another provision in this subpart; and
 - (c) must keep sufficient details of any such change, and the reasons for it, under section 22 of the Tax Administration Act 1994.

...

Worthless arrangements

- (8) If an excepted financial arrangement has no present or likely future market value and has been written off as worthless, its closing value is zero.

Use of value

- (9) The value determined under this section is—
- (a) the closing value of the excepted financial arrangement for the purposes of section CH 1 (Adjustment for closing values of trading stock, livestock, and excepted financial arrangements); and
 - (b) the opening value of the excepted financial arrangement for the next income year for the purposes of section DB 49 (Adjustment for opening values of trading stock, livestock, and excepted financial arrangements).

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.

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK DETERMINATION 2016

Note to this determination

This note does not form part of the national average market values of specified livestock determination 2016 ("the determination") but are produced to aid taxpayers and their agents in their understanding of how the values contained in this determination are arrived at and how they should be used.

Section EC 15 of the Income Tax Act 2007 ("the Act") requires the Commissioner of Inland Revenue ("the CIR") to make a determination declaring the national average market values of certain types and classes of livestock ("the NAMVs"). This determination is published in May each year.

These NAMVs are used by livestock owners to value their livestock on hand where owners have elected to use the herd scheme to value livestock in an income year.

As the name of this determination suggests, NAMVs provide the national average value of the specified livestock classes. As such they may not always reflect the market value of the livestock of a particular taxpayer, or of a particular region. This being so, the values are not intended to be used for any other purpose than that for which they are produced; valuing livestock of taxpayers who have elected to value their livestock under the herd scheme in the income year for which the determination relates.

In order to ascertain the market value of the various classes of livestock the CIR contracts with a number of experienced livestock valuers situated throughout the country¹. Each valuer is asked to provide the market value of the various livestock classes located in their region. There is generally more than one valuer contracted for each region. The market valuations required are for "good quality on-farm animals" as at 30 April. From these values the CIR then calculates the national average market value for each livestock class. In the case of sheep, beef, dairy cattle and deer classes a weighted average (based on total livestock numbers for a type of livestock in that region compared to the national herd numbers for that type of livestock²) is used. Because of the relatively low numbers of livestock, a straight average is used for the remaining livestock types.

¹ 38 valuers were contracted for the 2016 determination.

² Numbers are based on data collated by Statistics New Zealand.

National Average Market Values of Specified Livestock Determination 2016

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2016".

This determination is made in terms of section EC 15 of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2015-2016 income year.

For the purposes of section EC 15 of the Income Tax Act 2007 the national average market values of specified livestock, for the 2015-2016 income year, are as set out in the following table.

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK

| Type of livestock | Classes of livestock | Average market value per head \$ |
|--------------------------------------|---|----------------------------------|
| Sheep | | |
| | Ewe hoggets | 92.00 |
| | Ram and wether hoggets | 84.00 |
| | Two-tooth ewes | 133.00 |
| | Mixed-age ewes (rising three-year and four-year old ewes) | 117.00 |
| | Rising five-year and older ewes | 96.00 |
| | Mixed-age wethers | 68.00 |
| | Breeding rams | 304.00 |
| Beef cattle | | |
| <i>Beef breeds and beef crosses:</i> | | |
| | Rising one-year heifers | 726.00 |
| | Rising two-year heifers | 1079.00 |
| | Mixed-age cows | 1273.00 |
| | Rising one-year steers and bulls | 842.00 |
| | Rising two-year steers and bulls | 1229.00 |
| | Rising three-year and older steers and bulls | 1468.00 |
| | Breeding bulls | 2571.00 |

| Type of livestock | Classes of livestock | Average market value per head \$ |
|---|--|----------------------------------|
| Dairy cattle | | |
| <i>Friesian and related breeds, Jersey and other dairy breeds:</i> | | |
| | Rising one-year heifers | 530.00 |
| | Rising two-year heifers | 1077.00 |
| | Mixed-age cows | 1356.00 |
| | Rising one-year steers and bulls | 615.00 |
| | Rising two-year steers and bulls | 1003.00 |
| | Rising three-year and older steers and bulls | 1295.00 |
| | Breeding bulls | 1607.00 |
| Deer | | |
| <i>Red deer, wapiti, elk, and related crossbreeds:</i> | | |
| | Rising one-year hinds | 223.00 |
| | Rising two-year hinds | 397.00 |
| | Mixed-age hinds | 438.00 |
| | Rising one-year stags | 263.00 |
| | Rising two-year and older stags (non-breeding) | 543.00 |
| | Breeding stags | 1775.00 |
| <i>Other breeds:</i> | | |
| | Rising one-year hinds | 101.00 |
| | Rising two-year hinds | 175.00 |
| | Mixed-age hinds | 232.00 |
| | Rising one-year stags | 119.00 |
| | Rising two-year and older stags (non-breeding) | 218.00 |
| | Breeding stags | 409.00 |
| Goats | | |
| <i>Angora and angora crosses (mohair producing):</i> | | |
| | Rising one-year does | 41.00 |
| | Mixed-age does | 56.00 |
| | Rising one-year bucks (non-breeding)/wethers | 42.00 |
| | Bucks (non-breeding)/wethers over one year | 50.00 |
| | Breeding bucks | 321.00 |
| <i>Other fibre and meat producing goats (Cashmere or Cashgora producing):</i> | | |
| | Rising one-year does | 38.00 |
| | Mixed-age does | 52.00 |
| | Rising one-year bucks (non-breeding)/wethers | 39.00 |
| | Bucks (non-breeding)/wethers over one year | 49.00 |
| | Breeding bucks | 313.00 |

| Type of livestock | Classes of livestock | Average market value per head \$ |
|-------------------------------|---|----------------------------------|
| <i>Milking (dairy) goats:</i> | | |
| | Rising one-year does | 350.00 |
| | Does over one year | 420.00 |
| | Breeding bucks | 280.00 |
| | Other dairy goats | 30.00 |
| Pigs | | |
| | Breeding sows less than one year of age | 223.00 |
| | Breeding sows over one year of age | 279.00 |
| | Breeding boars | 405.00 |
| | Weaners less than 10 weeks of age (excluding sucklings) | 77.00 |
| | Growing pigs 10 to 17 weeks of age (porkers and baconers) | 152.00 |
| | Growing pigs over 17 weeks of age (baconers) | 223.00 |

This determination is signed by me on the 11th day of May 2016.

Vanessa Montgomery
LTS Manager
Technical Standards

CPI ADJUSTMENT 16/01 FOR DETERMINATION DET 09/02: STANDARD-COST HOUSEHOLD SERVICE FOR CHILDCARE PROVIDERS

In accordance with the provisions of Determination DET 09/02, as published in *Tax Information Bulletin* Volume 21, Number 4 (June 2009), Inland Revenue advises that, for the 2016 income year:

- (a) The variable standard-cost component will be \$3.43 per hour per child; and
- (b) The administration and record keeping fixed standard-cost component will be \$336 per annum, for a full 52 weeks of childcare services provided.

The above amounts have been adjusted as a consequence of the annual movement of the Consumers Price Index for the twelve months to March 2016, which showed a small increase of 0.4%. For childcare providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2015 to 31 March 2016.

CPI ADJUSTMENT 16/02 FOR DETERMINATION DET 05/03: STANDARD-COST HOUSEHOLD SERVICE FOR BOARDING SERVICE PROVIDERS

In accordance with the provisions of Determination DET 05/03, as published in *Tax Information Bulletin* Vol 17, No 10 (December 2005), Inland Revenue advises that, for the 2016 income year:

- (a) The weekly variable standard-cost for one to two boarders will be \$257 each; and
- (b) The weekly variable standard-cost for third and subsequent number of boarders will be \$210 each.

The above amounts have been adjusted as a consequence of the annual movement of the Consumers Price Index for the twelve months to March 2016, which showed an increase of 0.4%. For boarding service providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2015 to 31 March 2016.

OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject.

CS 16/01: COMMISSIONER'S STATEMENT

OECD INFORMATION SHARING REQUIREMENTS FOR TAXPAYER RULINGS AND DETERMINATIONS

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter. The Statement is not a consultative document.

Following the release of the report *Addressing Base Erosion and Profit Shifting* in February 2013, OECD and G20 countries adopted a 15-point Action Plan to address Base Erosion and Profit Shifting (BEPS) activities. As a member of the OECD, New Zealand is involved in this process.

Action 5 of the BEPS Action Plan, titled *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, requires OECD and G20 countries, including New Zealand, to exchange information spontaneously about taxpayer-specific rulings issued on cross-border activities. This is a "minimum standard" that New Zealand, as a member of the OECD, and a party that has approved and endorsed the OECD Council of Ambassadors' recommendations, is required to comply with.

The OECD has identified six categories of taxpayer-specific rulings that, in the absence of compulsory spontaneous exchange of information, could give rise to BEPS concerns:

- (a) Taxpayer-specific rulings related to preferential regimes (although New Zealand does not have any preferential regimes).
- (b) Cross-border unilateral advance pricing agreements (APAs) and any other cross-border unilateral tax rulings (such as ATRs) covering transfer pricing or the application of transfer pricing principles.
- (c) Cross-border rulings providing for a unilateral downward adjustment to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial/commercial accounts.
- (d) Permanent establishment rulings, ie rulings concerning the existence or absence of, and/or the attribution of profits to, a permanent establishment by the country giving the ruling.
- (e) Related party conduit rulings.

- (f) Any other type of ruling that, in the absence of spontaneous information exchange, gives rise to BEPS concerns.

The information exchange obligations will apply to:

- past rulings (those issued on or after 1 January 2010 that were still in effect on or after 1 January 2014); and
- future rulings (those issued on or after 1 April 2016).

The Commissioner's information exchange obligations cover all private and product rulings, advance pricing agreements and financial arrangements determinations that come within the above criteria. The Commissioner will receive rulings information from other countries on a reciprocal basis, which will provide helpful intelligence.

The Commissioner is required to ensure that information regarding rulings considering the above issues is exchanged within three months of the ruling being issued. The Commissioner will decide whether a ruling falls into any of the above categories. If it does then the Commissioner will prepare a summary of the ruling to be shared. The summary must include the date of issue, the period covered by the ruling, the type of ruling and a short summary of the issues covered, along with some basic information on the applicant (ie, IRD number, name, address and business activity). This may be followed by an exchange of the ruling itself on request.

Each case will need to be determined on its specific facts and circumstances, as not all cross-border rulings will be subject to the new exchange requirements. Consistent with the Commissioner's approach for sharing information under double tax agreements and the *Convention on Mutual Administrative Assistance in Tax Matters*, the Commissioner will not be notifying taxpayers when their rulings or information are shared.

The nature of the ruling will determine the countries the information has to be provided to. However, they will usually include the countries of residence of all the parties materially impacted by the transactions covered by the ruling, and the country of residence of the ultimate parent company, and immediate parent company, of the applicant. To protect the secrecy of taxpayer information, information will only be shared with countries where New Zealand has a double tax

agreement in place, and with parties to the *Convention on Mutual Administrative Assistance in Tax Matters*.

Any queries on this item can be sent to rulings@ird.govt.nz

2016 REVIEW OF THE COMMISSIONER'S MILEAGE RATE FOR EXPENDITURE INCURRED FOR THE BUSINESS USE OF A MOTOR VEHICLE

Operational Statement 09/01 ("OS") published in the *Tax Information Bulletin* Volume 21, Number 3 (May 2009) provides the Commissioner's statement of a mileage rate for expenditure incurred for the business use of a motor vehicle (OS 09/01 can be viewed at the Inland Revenue website www.ird.govt.nz/technical-tax/op-statements/). This OS provides that the Commissioner will review mileage rate on a yearly basis.

A recent review of the Commissioner's mileage rate, results in a reduction to the rate to 72 cents per kilometre for both petrol and diesel fuel vehicles for the 2016 income year. The weighted average rate of 0.71975 cents per kilometre is calculated for the 2016 income year, compared to a weighted average of 0.73971 for the 2015 income year. The reduction is largely due to a lower average fuel costs during the 2016 income year (petrol \$1.955 and diesel \$1.178) and overall lower operating costs. The 2016 income year for business taxpayers with a standard 31 March balance date, runs from 1 April 2015 to 31 March 2016.

The Commissioner is required to set a mileage rate for persons whose business travel is 5,000 km or less in an income year. The mileage rate is set retrospectively for persons required to file a return for business income, so that the rate reflects the average motor vehicle operating costs for an income year. Those persons who meet the criteria have a choice of using the mileage rate method or they may use actual costs if they consider that the Commissioner's mileage rate does not reflect their true costs. Taxpayers that choose to use actual costs are required to keep records to support any expenditure claimed.

The Commissioner does not propose to amend the returns for taxpayers who have already filed their 2016 returns using the 2015 mileage rate.

The Commissioner accepts that employers may use the 2016 vehicle mileage rate as a reasonable estimate of costs when they reimburse employees for the use of their private vehicle for business related travel for a current income year (post 1 April 2016).

Also, employers may use an alternative estimate other than the Commissioner's vehicle mileage rate when reimbursing employees for use of their private vehicle for employment related use. It is accepted that employers may use the motor vehicle running cost data published by other reputable sources, for example the New Zealand Automobile Association Incorporated, as an alternative reasonable estimate for reimbursement of employees.

The mileage rate does not apply in respect of motor cycles, hybrid and/or electric motor vehicles as these modes of transport are not commonly used for business purposes. Any self-employed persons who use these forms of transport for business purposes will need to calculate their actual expenditure or in the situation of an employer reimbursement, they may make a reasonable estimate of the employee's costs.

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 16/03: GOODS AND SERVICES TAX - GST TREATMENT OF BARE TRUSTS

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

This Question We've Been Asked is about ss 51, 57(2), 60(1) and 60(1B).

Question

1. Is it the trustee or the beneficiary of a bare trust who makes supplies in respect of the trust property for GST purposes?

Answer

2. It is the beneficiary of a bare trust who makes supplies in respect of the trust property for GST purposes, unless the trustee and the beneficiary agree otherwise under s 60(1B). This is because it is the beneficiary that carries on any taxable activity and may be registered or liable to be registered under s 51.

Explanation

3. Any reference to "beneficiary" in this Question We've Been Asked includes "beneficiaries".
4. This Question We've Been Asked applies once it has been established that a trustee holds property on bare trust for a beneficiary. Whether a bare trust exists in any given situation must be determined on the facts of each case.

What is a bare trust?

5. A bare trust is a type of trust under which the trustee holds property on trust without any duties to perform other than to convey the trust property to the beneficiary or as the beneficiary directs. The reference to "duties" in this definition is to duties that the settlor has specified. For example, the trustee may have been appointed to hold the property as nominee, or the settlor may have required that the beneficiary be maintained until becoming entitled to call for capital and income on reaching the age of majority. Once the beneficiary reaches the age of majority, the trustee no longer has a duty to maintain the beneficiary. In both situations, the trustee is "bare" of any duties specified by the settlor. However, so long as a trustee holds property on trust, they always retain their legal duty to take reasonable care of the trust property. The trustee cannot escape this duty: *Herdegen v FCT* 88 ATC

4995 (FCA); *Waters' Law of Trusts in Canada* (4th ed, Carswell, Toronto, 2012) at 33-34.

6. Therefore, a bare trustee has not only a duty to transfer the trust property to the beneficiary (or as directed by the beneficiary), but also a legal duty to take reasonable care of the trust property in the meantime: *Herdegen*; *CGU Insurance Ltd v One Tel Ltd (in liquidation)* [2010] HCA 26; *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 24 NSWLR 370 (CA); *ISPT Nominees Pty Ltd v Chief Commissioner of State Revenue* [2003] NSWSC 697.
7. What a bare trustee must do to fulfil their duty to protect trust property depends on the nature of the trust property and any threats to the trust property. However, a bare trustee must refrain from active management that does not fall within the duty to maintain the trust property: *Bruton Holdings Pty Ltd (in liquidation) v FCT* (2011) 193 FCR 442 (FCAFC).

When can a bare trust arise?

8. A bare trust can be created by an express declaration of trust, either in writing or orally. It can also arise without a declaration of trust. One of the most common scenarios in which a bare trust arises is where a purchaser (the beneficiary) provides someone else (usually called a nominee) with the purchase money to purchase an asset. This type of bare trust may also be described as a resulting trust: *Herdegen*.
9. The question of which party makes supplies for GST purposes arises because the bare trustee is likely to have legal ownership of the trust property, but the beneficiary is absolutely entitled to the trust property. Before considering which party makes supplies for GST purposes, we must consider which party is carrying on the taxable activity. The GST Act is concerned only with supplies that are made in the course or furtherance of a taxable activity.

Can a bare trustee carry on a taxable activity?

10. A taxable activity is an activity that is carried on continuously or regularly and that involves or is intended to involve, in whole or in part, the supply of goods and services to any other person. To be a taxable activity, the activity need not be carried

on for pecuniary profit: s 6(1)(a). An activity, in the context of ss 6 and 8, points to the combination of tasks undertaken or course of conduct pursued by the registered person: *CIR v Bayly* (1998) 18 NZTC 14,073 (CA).

11. In the context of a bare trust (and the question being considered), any taxable activity is likely to involve the property held by the bare trustee. The issue arises because it is generally considered that the range of activities that a bare trustee could undertake (and remain a bare trustee) would not extend to carrying on a taxable activity.
12. However, the Commissioner considers that the activities of a bare trustee could meet the definition of "taxable activity" where the bare trustee is discharging their duty to:
 - transfer property in accordance with the directions of the beneficiary, or
 - maintain the trust property.
13. An example where this may occur is where a bare trustee in a nominee situation holds commercial property that is subject to a lease. A leasing activity may be a taxable activity: *Bayly*.
14. Therefore, we must consider whether it is the trustee or the beneficiary of a bare trust who carries on the taxable activity and makes and receives supplies in respect of the trust property for GST purposes.
17. An express agency contract is not necessary for an agency relationship to exist. An agency agreement can be implied from the conduct of the parties: *Papalia v Romeo* [2011] NSWSC 696; *Marr v Parkin* [2014] NZHC 3269.
18. A bare trustee has no independent power or discretion relating to the trust property other than to take reasonable care of the trust property. Therefore, any supply involving the trust property that does not fall within that duty must be made on the instructions of the beneficiary. In such circumstances, in the absence of an express agency, there would be an implied agency: *Trident Holdings Ltd v Danand Investments Ltd* (1988) 64 OR (2d) 65 (ONCA).
19. The Commissioner considers that the relationship between a beneficiary and a bare trustee acting on the directions of the beneficiary is predominantly an agency relationship: *Trident Holdings*; *Collins v The Queen* (2002) GTC 314 (TCC); Butler (ed), *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at [16.6.1], fn 102; *Laws of New Zealand: Agency* at [5]; JD Heydon, MJ Leeming, *Jacobs' law of trusts in Australia* (7th ed, LexisNexis Butterworths, Chatswood, 2006) at [210]; Nuncio D'Angelo, *Commercial trusts* (LexisNexis Butterworths, Chatswood, 2014) at [3.34] and [3.46].
20. Section 60 applies to agency relationships. This means that:
 - a supply a bare trustee makes for and on behalf of the beneficiary is treated as a supply the beneficiary makes, unless the bare trustee and the beneficiary agree in writing to treat the supply as two separate supplies (ie, a supply from the beneficiary to the bare trustee and a supply from the bare trustee to the recipient): s 60(1) and 60(1B);
 - a supply made to a bare trustee for and on behalf of the beneficiary is treated as a supply made to the beneficiary: 60(2).

Who makes and receives supplies under a bare trust?

15. The Commissioner considers that it is the beneficiary of a bare trust who carries on the taxable activity and makes and receives supplies in respect of the trust property for GST purposes. Any taxable activity is carried on by the beneficiary, rather than a bare trustee, based on agency principles and case law.

Agency principles

16. The trustee is the legal owner of trust property. Generally, legal ownership is the basis for claiming GST inputs and returning outputs: *Case N39* (1991) 13 NZTC 3,333; *Case P84* (1992) 14 NZTC 4,561; *Pine v CIR* (1998) 18 NZTC 13,570 (CA); *Case T35* (1997) 18 NZTC 8,235. A person may, however, be both a trustee and an agent. An agent is a person who has authority to act for someone (called the principal) to create a legal relationship between the principal and someone else: *CIR v Capital Enterprises Ltd* (2002) 20 NZTC 17,511 (HC); *Case 14/2014* (2014) 26 NZTC 2-024. The acts of an agent are attributed to the principal under the common law of agency: *Lilyvale Hotel Pty Ltd v FCT* 2009 ATC 20-094 (FCAFC).

21. The effect of s 60 is that any taxable activity carried on by a bare trustee that involves making supplies on behalf of a beneficiary is carried on by the beneficiary rather than the trustee (unless the trustee and the beneficiary agree otherwise in writing under s 60(1B)).
22. Therefore, the beneficiary (rather than the trustee) is the person entitled or required to register for GST for that taxable activity.

Case law principles

23. However, the Commissioner accepts that the agency principles may not apply in every instance where there is a bare trust. In these circumstances, case law

suggests that a supply to or from a bare trustee would be treated as a supply to or from the beneficiary: *Case R1* (1994) 16 NZTC 6,001; *CIR v Campbell Investments & Anor* (2004) 21 NZTC 18,559 (HC). While *Case R1* was overturned on appeal (after further evidence established that a bare trust did not exist: *Union Corporate Services Ltd v CIR* (1997) 18 NZTC 13,151 (HC)), *Case R1* makes it clear that, had a bare trust existed, it is the beneficiary of the trust who would have been the person carrying on the taxable activity and receiving the supply in question. In *Campbell Investments*, a syndicate of three taxpayers carried on the taxable activity of renting commercial properties. One member of the syndicate held the legal title to the properties on trust for the syndicate. The trustee later transferred the legal title to the properties to the members of the syndicate. Wild J held that there was no supply as the beneficial owners already owned the properties and were entitled to have legal title transferred to them on request. He considered that the transfer of their share of the legal title to the properties from one syndicate member to the other members was "irrelevant" to the carrying on of the syndicate's taxable activity. He noted that the syndicate's taxable activity had previously been carried on without issue while one syndicate member held legal title to the properties.

Conclusion

24. Therefore, the Commissioner considers that the beneficiary (rather than the trustee) remains the person entitled or required to register for GST. In most cases, this will be because the agency provisions of the Act apply to put the position beyond doubt. In situations where agency principles do not apply, case law supports the position that the beneficiary carries on the taxable activity and makes and receives any supplies.

Does s 57(2) apply to a bare trust?

25. Section 57(2) contains special rules that apply when unincorporated bodies such as trusts are registered for GST purposes. Section 57(2) deems any supplies made or received in the course of carrying on the body's taxable activity to be made or received by the body (and not the members of the body). The section also confirms that the members of the body are not liable to register for GST. The Commissioner considers that s 57(2) does not apply to the trustees of a bare trust because it will be the beneficiary under a bare trust who carries on any taxable activity and is therefore the person entitled or required to register for GST (unless the trustee and the beneficiary agree otherwise in writing under s 60(1B)).

26. However, there may be more than one beneficiary under a bare trust (like the syndicate members in *Campbell Investments*). Given that the Commissioner considers it is the beneficiaries under a bare trust who make supplies and therefore conduct any taxable activity, that group of beneficiaries may be an unincorporated body for the purposes of s 57(2). Whether the beneficiaries are an unincorporated body must be determined on the facts of each case by considering whether there is sufficient comity, agreement (formal or otherwise), or actions indicating a joint endeavour for the beneficiaries to be an unincorporated body: *Newman & Ors v CIR*, *Holdsworth & Ors v CIR*, *Hair & Ors v CIR* (2000) 19 NZTC 15,666 (HC); *Case P70* (1992) 14 NZTC 4,469; *Case T40* (1997) 18 NZTC 8,267; *Case U19* (1999) 19 NZTC 9,186.

What about a bare trustee's transfer of trust property to the beneficiary?

27. A bare trustee's transfer of trust property to the beneficiary is not a supply, as the beneficiary already owns the property beneficially and is entitled to have legal title transferred to them on request: *Campbell Investments*.

What if the bare trustee is registered for GST instead of the beneficiary?

28. If you think you may have taken a tax position in past tax years that is different from the Commissioner's position in this Question We've Been Asked, discuss the matter with your tax advisor, or Inland Revenue, and consider making a voluntary disclosure.

Examples

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

Example 1 - Bare trustee enters into lease agreements on behalf of beneficiaries

30. Starlight Nominees Ltd is the legal owner of three commercial rental properties as bare trustee on behalf of two business partners, Greg and Rhonda. Greg and Rhonda take care of the day-to-day activities of the rental business and instruct Starlight to enter into all leases and other contracts as required. There is no written agreement between Starlight and Greg and Rhonda under s 60(1B). In this case, Starlight is both bare trustee and agent for Greg and Rhonda. The supply of the properties for rent is treated as a supply made by Greg and Rhonda: s 60(1), *Case R1* and *Campbell Investments*.

Example 2 - Bare trustee transfers trust property to third party

31. Greg and Rhonda decide to sell one of the properties and instruct Starlight to enter into an agreement for sale and purchase of real estate with the purchaser and to transfer the property to the purchaser on settlement. In this case also, Starlight is both trustee and agent for Greg and Rhonda. The supply of the property to the purchaser is treated as a supply made by Greg and Rhonda: s 60(1), *Case R1* and *Campbell Investments*.

Example 3 - Bare trustee transfers properties to beneficiaries

32. Greg and Rhonda now decide to hold the legal title to the remaining properties in their own names. They instruct Starlight to transfer the legal title in the properties to them. The transfer of the legal title to Greg and Rhonda is not a supply to them for GST purposes, because Greg and Rhonda already own the properties beneficially.

References

| |
|---|
| Subject references |
| GST, bare trust, agency |
| Legislative references |
| Goods and Services Tax Act 1985 - ss 2(1), 6(1), 8, 51, 57(2), 60(1), (1B) and (2) |
| Case references |
| <i>Bruton Holdings Pty Ltd (in liquidation) v FCT</i> (2011) 193 FCR 442 (FCAFC) |
| <i>Case 14/2014</i> (2014) 26 NZTC 2-024 |
| <i>Case N39</i> (1991) 13 NZTC 3,333 |
| <i>Case P70</i> (1992) 14 NZTC 4,469 |
| <i>Case P84</i> (1992) 14 NZTC 4,561 |
| <i>Case R1</i> (1994) 16 NZTC 6,001 |
| <i>Case T35</i> (1997) 18 NZTC 8,235 |
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| <i>CGU Insurance Ltd v One Tel Ltd (in liquidation)</i> [2010] HCA 26 |
| <i>CIR v Campbell Investments & Anor</i> (2004) 21 NZTC 18,559 (HC) |
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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, 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.

HIGH COURT FINDS FOR COMMISSIONER ON TAX AVOIDANCE AND IMPOSES AN ABUSIVE TAX POSITION SHORTFALL PENALTY

| | |
|----------------------|---|
| Case | Tale Holdings Limited v Commissioner of Inland Revenue |
| Decision date | 22 April 2016 |
| Act(s) | Tax Administration Act 1994 ss 141D, 141FB and Goods and Services Tax Act 1985 ss 9, 11, 76 |
| Keywords | Tax Avoidance, sale of a development, zero-rating of land, GST input credit, abusive tax position shortfall penalty |

Summary

Tale Holdings Limited ("Tale") entered into an arrangement to purchase a property development ("Delta") from Te Anau Lakeside Estates Limited ("Te Anau") facing liquidation action. Under the arrangement the purchase price was set according to the amount owed under Te Anau's mortgage. Tale took the property subject to the mortgage and paid no money to Te Anau. Tale claimed a goods and services tax ("GST") input tax deduction for the tax fraction of the purchase price and Te Anau did not pay any GST output tax. The Court held that:

- Tale was engaged in an arrangement that had a tax avoidance purpose or effect that was not merely incidental;
- The Commissioner of Inland Revenue ("the Commissioner") was correct to disallow the whole of the GST refund sought by Tale; and
- The Commissioner's assessment of a shortfall penalty was correct.

Impact

The black letter law position in this case was determined under the GST legislation prior to 1 April 2011 (after which date transactions between GST-registered parties involving land, or in which land is a component, are mandatorily zero-rated). On black letter law the taxpayer was allowed the GST input claim, but the High Court upheld the voiding of the arrangement as tax avoidance.

Facts

Tale acquired a land subdivision called Delta from Te Anau. Tale did not pay any money for Delta. Instead, Tale acquired Delta on the basis it would accept liability for a debt of approximately \$8.5 million, which Te Anau owed the bank. At the time, the rateable value of Delta was approximately \$4.2 million and its market value was approximately \$3.2 million.

Tale claimed a GST refund of \$936,629 based upon the "purchase price" of Delta and Te Anau did not pay any output tax on the sale of Delta to Tale.

The Commissioner concluded Tale was engaged in a tax avoidance arrangement and also imposed an abusive tax position shortfall penalty (ATP shortfall penalty) of 100 per cent, reduced by 50 per cent for previous good behaviour in accordance with s 141FB of the Tax Administration Act 1994 (TAA), of the GST refund denied to Tale.

Decision

Was there an arrangement for the purposes of s 76 of the Goods and Services Tax Act 1985 ("GST Act")?

Tale argued that the Commissioner identified in her submissions two new steps in the arrangement (compared to in her Statement of Position) and that the inability of the Commissioner to accurately identify what the alleged arrangement was pointed to the fact that there was no agreement which could be identified as constituting an arrangement.

The Court considered that although the Commissioner should be as precise as possible when identifying what constitutes an arrangement (in the dispute process documents), the Commissioner's statutory obligations do not extend to providing the taxpayer with an extensive analysis of the facts and law she relies upon; rather the Commissioner must provide a concise statement of the key facts and the law in sufficient detail to inform of the grounds of the proposed adjustment (TAA, s 89f(2)(b)).

The Court noted that aspects of the Commissioner's case about what constituted the arrangement had evolved, there were five key elements that remained since the time the Commissioner issued her Notice of Proposed Adjustment ("NOPA") that satisfied the definition of "arrangement."

Did the arrangement have a tax avoidance purpose or effect?

In order to identify whether the arrangement in this case had a tax avoidance purpose or effect, the Court first focussed on the objectives of the GST regime, and then upon the effect and purpose of the arrangement.

The Court found particular relevance in two features of the GST regime: (1) that transactions will be driven by market forces; and (2) that over time there will be a netting off of the GST components of sales and purchases - the Act does not contemplate a taxpayer claiming GST input tax credits when there is no possibility of output tax being paid over time.

In determining the purpose of the arrangement, the Court focused on the artificiality of the purchase price, the fact that Tale did not pay anything for Delta and that the transaction was unlikely to result in GST being paid.

As to the artificiality of the purchase price, the Court noted that Tale did not obtain an independent valuation of Delta to determine if the purchase price was consistent with the market value.

The Court noted that the assumptions made by Tale's witnesses regarding the value of Delta at the time of purchase were very optimistic and Tale did not call any independent evidence to support those assumptions or to challenge the conclusions of the expert called by the Commissioner concerning the market value of Delta at the time of purchase. The Court found that the expert's assessment of the market value of Delta at \$3,200,000 at the time Tale acquired it was accurate.

The Court was satisfied that the transaction at the heart of the arrangement was not a normal commercial transaction because the shareholders of Tale did not provide any equity and had no capital at risk and because Tale acquired Delta at a price which was set by reference to Te Anau's debt to the bank, not the market value of the land in question.

The Court also considered that because Tale would be unlikely to sell Delta at a price greater than the amount required to pay the bank mortgage in full, Tale would only ever be able to pay output tax on the sale of Delta to the extent that the bank would allow. This would result in Tale claiming and recovering an input tax deduction and not paying the output tax that would normally be expected to be present where transactions are governed by ordinary market forces. This is exactly what transpired. Allowing Tale to obtain a GST refund for the acquisition of Delta in such circumstances defeats the revenue collection purpose of the GST Act and does not result in netting off of inputs and outputs over time.

The Court accordingly held that the arrangement in this case was designed to alter the incidence of GST in a way which could not have been within the contemplation of Parliament. As a result, the arrangement clearly had a tax avoidance purpose or effect.

Did the arrangement have a tax avoidance purpose or effect which was not merely incidental?

The Court held that the tax avoidance purpose or effect of this arrangement was more than merely incidental because:

- 1) Tale acknowledged that it was part of the plan it engaged in that it would receive a GST refund, which was to be applied to the debt owed to the bank;
- 2) Tale accepted that obtaining the GST refund was a key objective in itself. The refund was likely to be its most significant source of revenue, at least in the initial state of development and sales by Tale; and
- 3) The GST refund sought was based on a contrived and artificial price that had no resemblance to the true market value of Delta which involved the suspension of ordinary market forces.

Was it wrong for the Commissioner to disallow the entire GST refund sought by Tale?

Tale suggested that if the transaction had an inflated value then the Commissioner was required to reconstruct the transaction and assign an appropriate value to it in order to calculate the GST refund to which Tale was entitled. However, the Commissioner did not undertake an adjustment under s 76(3) of the GST Act. The onus was accordingly on Tale to demonstrate that the transaction could not have been zero-rated and that commercial objectives were connected to the arrangement.

The Court held that although Tale had not been registered for GST at the time of sale and there was no agreement in writing that the supply was of a going concern, the sale by Te Anau to Tale was in all other respects of a going concern which was able to be zero-rated for GST purposes. There

was no reason why Tale could not have achieved its alleged commercial objectives by entering into the arrangement in a way that was tax neutral and did not involve tax avoidance.

Was the Commissioner's assessment of a shortfall penalty correct?

The Court considered that there were similarities between this arrangement and the one in *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2008] NZSC 116, [2009] 2 NZLR 359. In both cases the purchaser was a shell company, the price was not paid in economic terms, the price "paid" was inflated and GST was not paid by the vendor. The Court concluded that at the time Tale took its tax position there was significant Supreme Court case law which strongly indicated the position being taken by Tale was not, when viewed objectively, likely to be correct. The Commissioner was therefore correct when she assessed Tale as being liable for an Abusive Tax Position shortfall penalty under s 141D of the TAA.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

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

Legal and Technical Services

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

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

Policy and Strategy

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

Litigation Management

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

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