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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
EPR616	Draft: Standard for the use of a valid electronic signature on documents provided to the Commissioner	This standard sets out the guidelines for the use of electronic signatures on information and documents provided to Inland Revenue. It describes the circumstances in which Inland Revenue accepts documentation and information under an electronic signature.	22 August 2016

IN SUMMARY

Interpretation statements

IS 16/01: Income tax – computer software acquired for use in a taxpayer's business

This item covers the income tax treatment for taxpayers who purchase, lease, licence, subscribe for, develop, or commission computer software for use in their business. It updates and replaces the 1993 Policy Statement on computer software published in an Appendix to *Tax Information Bulletin* Vol 4, No 10 (May 1993) - except for the parts that deal with taxpayers carrying on a software development business which will be dealt with separately. The item contains reference to the interpretation statement IS 08/02: "Deductibility of Feasibility Expenditure" (*Tax Information Bulletin* Vol 20, No. 6 (July 2008)). Comments in the Court of Appeal decision *CIR v Trustpower Ltd* [2015] NZCA 253 have questioned some aspects of that statement. This item reflects that until that litigation is resolved, the Commissioner will continue to apply the position set out in the IS 08/02.

Operational statements

OS 16/01: Filing an IR10 and Section 108 of the Tax Administration Act 1994

This statement sets out the Commissioner of Inland Revenue's preference for the ways taxpayers may bring income to her attention when filing their annual return. Other than the return itself, other common ways are to complete the *Financial statements summary (IR10)* or to include a set of financial statements with their annual return.

Standard practice statements

SPS 16/02: Child support and domestic maintenance - amendments to assessments

This standard practice statement (SPS) sets out how the Commissioner will exercise the discretion under s 87 of the Child Support Act 1991 (the Act) to amend assessments for child support and domestic maintenance to give effect to the Act. This includes assessments the Commissioner makes as a result of a voluntary agreement entered into by parties.

Questions we've been asked

QB 16/04: Goods and services tax -GST treatment of partnership capital contributions

This item considers whether a GST registered partnership is required to account for output tax on a capital contribution made by a partner. It concludes that the partnership is not required to account for output tax because the partnership does not make a supply. Where a partnership capital contribution is made in return for the transfer of an existing partnership interest, it is concluded that the supply of the partnership interest is made by the existing partner. It is not made by the partnership. Where the capital contribution is not made in return for the transfer of an existing partnership interest, for example on the initial creation of a partnership, it is concluded that no supply is made and, therefore, no GST can be charged.

Items of interest

Withdrawal of Standard Practice Statement GNL-170: Release of information

Standard practice statement ("SPS") GNL-170 issued September 2001 and published in *Tax Information Bulletin* Vol 13, No 9 has been withdrawn, effective immediately.

SPS GNL-170 provided guidelines on how Inland Revenue would handle requests for information made under the Official Information Act 1982 ("OIA") and the Privacy Act 1993 ("PA").

A review of SPS GNL-170 has concluded the SPS no longer reflects the Commissioner's approach to considering OIA and PA information requests. The Inland Revenue website **www.ird.govt.nz** will be updated to provide further information to customers on how they may send OIA and PA requests to Inland Revenue.

Legal decisions - case notes

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**

PRODUCT RULING – BR PRD 16/02

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 SKYCITY Entertainment Group Limited (SKYCITY) (IRD No: 62 854-472).

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CA 1(2), CE 1, CX 2, GA 1, HC 6, HC 7 and subpart CE.

This Ruling does not rule on or consider whether particular Participants hold their Plan Shares on capital account.

The Arrangement to which this Ruling applies

The Arrangement is the Executive Long-Term Incentive Plan 2009 (the Incentive Plan), which applies to executives (referred to as the Participants) of the SKYCITY Group, a group of companies wholly owned by SKYCITY. In summary, under the Incentive Plan, SKYCITY Auckland Holdings Limited (SKYCITY Auckland) advances to the trustee of the SKYCITY Executive Share Trust (the Trustee), as agent for the Participants, funds that are used to purchase SKYCITY shares (the Plan Shares). The Plan Shares are then held on trust for a restrictive period (usually three years). At the end of the restrictive period, if the Participant has met various performance hurdles, SKYCITY will pay to the Participant a cash bonus equal to the original Loan grossed up for tax, which will be used to repay the Loan, and the legal title in the Plan Shares will be transferred to the Participant. If the performance hurdles are not met, call or put options will be exercised so that the Trustee will be required to purchase the Plan Shares from the Participant for an amount equal to the amount of the outstanding Loan, settled by way of novation of the Loan to the Trustee.

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

Relevant documents

1. The documents relevant to the Arrangement are:
    - Pro Forma Offer Letter from SKYCITY to employees of SKYCITY Group (Offer Letter);
    - SKYCITY Executive Long-Term Incentive Plan Application Form (Application Form);
    - Executive Long-Term Incentive Plan Terms 2009 (versions dated 25 January 2011 and 17 October 2014) (Terms);
    - SKYCITY Simplified Disclosure Prospectus (versions dated 24 January 2011 and 14 August 2013) (Prospectus), which includes the Performance Hurdle Memorandum as a schedule (Hurdle Memo);
    - Deed of Trust relating to the SKYCITY long-term incentive plans dated 3 November 2009 (Trust Deed) entered into between SKYCITY and Public Trust (acting as the Trustee).
2. The documents, including those relating to future grants under the Arrangement, will be materially the same as those provided to Inland Revenue on 23 November 2015 and 11 December 2015.

Objectives of the Incentive Plans

3. The primary objective of the Incentive Plan is to encourage executives to become shareholders in SKYCITY, thus aligning their interests with those of other shareholders. The Incentive Plan:
    - aims to reward and retain key employees;
    - drives long-term performance and alignment of incentives of participants with the interests of SKYCITY's shareholders; and
    - encourages long-term decision-making.

The Arrangement

Invitation

4. Potential participants in the Incentive Plan are provided with an Offer Letter and the Application Form. These documents provide details of the number of Plan Shares offered, the price of the Plan Shares, and the terms of the grant, including terms surrounding the Loan (discussed further below). Potential participants also receive details of the performance hurdles, which are attached as a schedule to the Prospectus.
5. The Participant may accept the grant by signing and returning the Application Form within a prescribed timeframe. In accepting the grant, the Participant acknowledges that they are bound by the Terms.
6. To date, there have been seven grant dates for the Incentive Plan, as follows:
   - 2 September 2009
   - 31 August 2010
   - 2 March 2011
   - 31 August 2011
   - 29 August 2012
   - 28 August 2013
   - 27 August 2014
7. All New Zealand Participants are employed by SKYCITY Management Limited, which is associated with SKYCITY for the purposes of the Act. The Participants are not associated with SKYCITY or any of its subsidiaries for the purposes of the Act.

Terms of loan

8. On acceptance of the grant, SKYCITY Auckland advances an interest-free loan (the Loan) to the Trustee on behalf of, and at the request of, the Participant, solely for the purpose of purchasing the Plan Shares (cl 9(vii) of the Application Form and cl 4.4 of the Terms).
9. The Loan is only repayable by the application of a bonus payment if the performance hurdles are met or, if the performance hurdles are not met, by way of the novation arrangements that are triggered by the exercise of the put or call options (discussed further below) (cl 9(i) of the Application Form and cl 4.4 of the Terms). The Loan is repayable at the end of the restrictive period and otherwise in accordance with the Terms (cl 4.5 of the Terms).
10. The restrictive period is the period commencing when a beneficial interest is acquired by the Participant and ending when the performance hurdle has first been met (definition of Restrictive Period in the Terms). The restrictive period usually runs for three years. However, if the performance hurdles are not met at the initial performance testing date, there is a second and third testing date (being six and 12 months respectively after the initial performance testing date) that extend the restrictive period (explained in the Hurdle Memo).
11. Any dividends received in respect of a Participant's Plan Shares during the restrictive period (after the deduction of any tax) must be applied to partially repay the relevant Participant's Loan amount (cl 9(ii) of the Application Form and cl 4.8 of the Terms).

Acquisition and holding of Plan Shares

12. The Trustee uses the Loan proceeds to acquire Plan Shares on behalf of a Participant. The Trustee either acquires the shares on-market, is issued shares (either new or Treasury Stock) by SKYCITY, or transfers Plan Shares from the Unallocated Pool of Plan Shares that the Trustee already holds (cl 3.2 of the Terms and rules 1.1 and 5.5 of sch 1 to the Trust Deed).
13. The amount a Participant must pay for the Plan Shares is the volume weighted average sales price on the NZX Main Board over the ten business days commencing on the first business day following the company's Preliminary Full Year or Half Year Announcement, whichever is applicable (cl 4.1, and the definition of Offer Price in the Terms).
14. In respect of the Plan Shares, each Participant has the right to:
    - all cash dividends, capital returns or other cash distributions (cl 4.6 of the Terms) (SKYCITY will maintain a dividend-paying policy throughout the term of the Incentive Plans); and
    - exercise voting rights, either directly or by way of instructing the Trustee (cl 9.1 of the Terms).
15. During the restrictive period, a Participant cannot sell, transfer, mortgage, charge or otherwise encumber or dispose of the Plan Shares (cl 3 of the Application Form and cl 5.2 of the Terms).
16. Clause 2.11 of the Prospectus provides that, if a Participant requests to withdraw from the Incentive Plan prior to the end of the restrictive period, that Participant must transfer the beneficial interest in the Shares back to the Trustee under the terms of the Put and Call Options. However, the Applicant has confirmed that, despite this clause, Participants are required to obtain approval from the Board of SKYCITY to withdraw from the Incentive Plan. The

Applicant has confirmed that approval will only be considered in situations provided for in cl 2.13 of the Prospectus, which applies in situations of "serious hardship". For the avoidance of doubt, a situation where the value of the Plan Shares falls below the original purchase price paid by the Participant for those Plan Shares will not amount to "serious hardship". This Ruling will cease to apply if the Participants do withdraw from the Incentive Plan other than for reasons of "serious hardship", or as a result of ceasing to be employed with the SKYCITY Group, as discussed at [35] to [36]. Clause 10 of the Terms provides for corporate actions that may occur during the restrictive period. This includes consolidation or subdivision of shares, bonus issues, rights offers and share buy-backs. In these situations, cl 10 provides for any changes in the number of Plan Shares held on behalf of a Participant. Clause 10 also provides for what will happen if there is a takeover offer or amalgamation. In particular, cl 10 states when a Participant may be entitled to bring forward the performance testing date to determine whether Plan Shares will vest or be forfeited. The process for determining whether Plan Shares will vest or be forfeited is discussed further below.

17. The Trustee holds the Plan Shares as trustee on behalf of the Participant pursuant to the Terms and the Trust Deed. The Trustee is required to act in the interests of the Participants (cl 9.2 of the Terms). The Trustee must maintain an account for each Participant detailing the number of Plan Shares allocated and the Loan balance (rule 10.1 of sch 1 of the Trust Deed).

18. The Applicant considers that the SKYCITY Executive Share Trust is a "complying trust", as defined in s HC 10.

Performance hurdles and vesting

19. Under the Incentive Plan, each Participant's right to retain the Plan Shares allocated to them is dependent on the Total Shareholder Return (TSR) achieved by SKYCITY relative to comparable companies and other companies on the New Zealand and Australian share markets.

20. Plan Shares will be transferred to the Participants if SKYCITY achieves a TSR greater than or equal to the average of the:

    - Peer Median TSR – the TSR representing the 50th percentile of the TSRs of members of the Peer Comparative Group. The Peer Comparative Group is generally a group of 16 entities the Board of SKYCITY (Board) considers to be appropriate peers of SKYCITY.
    - Index Median TSR – the TSR representing the 50th percentile TSR of NZX50 companies at the date the Participant first acquires a beneficial interest in the Plan Shares.

21. If this hurdle is met, legal title in the Plan Shares is transferred to Participants on a straight-line basis from a 50% transfer if the SKYCITY TSR equals the 50th percentile, to a 100% transfer if the SKYCITY TSR is equal to the 75th percentile. In addition, the Board has discretion to determine that up to 25% of the Plan Shares can be transferred to the Participants if SKYCITY's TSR for the relevant assessment period does not exceed the average of the Peer Median TSR and Index Median TSR, but exceeds one or other of the Peer Median TSR or Index Median TSR.

22. All grants for the Incentive Plan have the same performance hurdles as those set out above, apart from the 27 August 2014 grant. For this grant, 50% of the Plan Shares were allocated to the Peer Median TSR Tranche and 50% of the Plan Shares were allocated to the Index Median TSR Tranche. Vesting of the Plan Shares in each Tranche is not interdependent. Therefore, the Board does not have discretion to determine that up to 25% of the Plan Shares can be transferred to the Participant if both hurdles are not met.

If the performance hurdles are achieved

23. To the extent that the performance hurdles are met, the Participant's employer or SKYCITY pays a cash bonus equal to the value of the original Loan to the Participant, grossed up based on the top marginal tax rate at the time the beneficial interest in the Plan Shares was acquired (cl 7.1 of the Terms). The after-tax amount of the bonus is paid to the Trustee and applied to repay the Loan balance (cl 7.2 of the Terms).

24. If dividends or other distributions have been received in relation to the Plan Shares during the restrictive period and applied in part payment of the Loan, the outstanding Loan balance is less than the after-tax amount of the bonus. In this situation, the balance of the bonus payment is paid to the Participant (cl 7.3 of the Terms).

25. In the 28 August 2013 and 27 August 2014 grants, cl 7.2 also stipulates that third-party source deductions (eg KiwiSaver, student loan or child support payments) should be deducted from the bonus payment. This may result in situations where the bonus does not fully cover the amount of the Loan balance. In that situation, the Participant is liable to pay the outstanding Loan balance (para 2.10 of the Prospectus).

26. The Trustee is required to transfer the legal title in the Plan Shares that vest as a result of meeting the performance hurdles within one month of the relevant performance testing date (cl 6.2 of the Terms). However, with the exception of the circumstances discussed at [34] to [35] below, the Plan Shares only vest if the Participant remains employed with the SKYCITY Group, and the Loan is repaid in full (cl 6.3 of the Terms).

If the performance hurdles are not met

27. To the extent performance hurdles are not met, no cash bonus is paid (cl 7.1 of the Terms).

28. In addition, to the extent performance hurdles are not met, the Participant is required to forfeit their Plan Shares (cl 8 of the Terms). This occurs either by the Trustee exercising a call option requiring the Participant to sell their beneficial interest in the Plan Shares to the Trustee or, failing that, by the Participant exercising a put option requiring the Trustee to purchase the Participant's beneficial interest in the Plan Shares (cl 8.4 of the Terms).

29. The consideration payable for the forfeited Plan Shares is the outstanding Loan balance relating to those shares. This is satisfied by the Participant novating all their rights and obligations under the Plan Shares and the Loan to the Trustee. After the novation, the Loan is owed by the Trustee to SKYCITY Auckland (cl 9(iv) of the Application Form and cl 8.5 of the Terms).

30. The Participant is not required to reimburse the Trustee for any loss in value of the forfeited Plan Shares compared to the outstanding Loan balance. Conversely, if the forfeited Plan Shares have increased in value, the Participant is not entitled to receive a benefit from the gain (cl 8.6 of the Terms).

31. If a call or demand is made by any person for repayment of the Loan other than in the circumstances expressly permitted (and summarised in this Arrangement Description), the put option will become immediately exercisable by the Participant (cl 9(vi) of the Application Form).

32. Where the Trustee purchases the beneficial interest in a Participant's Plan Shares, SKYCITY provides the Trustee with a Trustee Loan that the Trustee uses to repay the novated Loan originally granted to the Participant (rule 5.4 of sch 1 of the Trust Deed). The Trustee then holds the Plan Shares in the Unallocated Pool to be allocated to a future Participant at a later date (rule 5.3 of sch 1 of the Trust Deed).

33. Where Plan Shares from the Unallocated Pool are subsequently sold by the Trustee to a future Participant, the amount of the Loan granted to that future Participant, which is used to pay for those Plan Shares, is used by the Trustee to repay any outstanding Trustee Loans (rule 5.5(d)(i) of sch 1 of the Trust Deed). Any surplus, arising from a difference between the purchase price payable by the future Participant for the Plan Shares and the price the Trustee paid to purchase forfeited Plan Shares, is distributed to SKYCITY as beneficiary income (rule 5.5(d)(iii) of sch 1 of the Trust Deed).

Cessation of employment

34. If, in the period of 12 months preceding the initial performance testing date, the Participant:

    - gives notice terminating their employment as a result of a material change to the terms and conditions of employment resulting in a diminution of the Participant's status and responsibility without consent (definition of Fundamental Change in the Terms); or
    - has their employment terminated without cause;

    the Participant's Plan Shares continue to be held by the Trustee for the Participant until the first performance testing date. If the Plan Shares do not vest in the Participant at that date, the Plan Shares are forfeited as discussed above (cl 11.2 of the Terms).

35. If the Participant ceases to be employed as a result of an involuntary event (eg death, redundancy or medical incapacity), and the cessation date is on or after the date half way through the period from acquisition of the Plan Shares to the initial performance testing date, the Board may determine that some or all of the Plan Shares be transferred to the Participant at its discretion (cl 11.3 of the Terms). However, for Participants involved in the 27 August 2014 grant, where employment ceases due to medical incapacity or permanent disability, then the Plan Shares vest on a straight-line basis depending on the time elapsed from the acquisition date to the cessation date, and such vesting is not subject to the performance hurdles.

36. If the Participant ceases to be employed for any other reason, the Plan Shares are forfeited (cl 11.1 if the Terms).

37. For the avoidance of any doubt, this Ruling only applies to the extent that any of the events described in the Arrangement Description above occur during the period of this Ruling.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Trustee's purchase of the Plan Shares on behalf of a Participant does not give rise to any income to that Participant under subpart CE, provided the value of the Plan Shares on the date they are acquired by the Trustee on behalf of the Participant is equal to the price payable by the Participant for those Plan Shares.

b) Cash bonuses paid by SKYCITY or SKYCITY Management Limited to eligible Participants are income of the Participant under s CE 1(1)(a).

c) The transfer of legal title in the Plan Shares to a Participant does not result in the Participant deriving income under ss CA 1(2), CE 1(1) or HC 6.

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

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

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

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 April 2016 and ending on 6 April 2019.

This Ruling is signed by me on the 7th day of April 2016.

Howard Davis
Director (Taxpayer Rulings)

PRODUCT RULING – BR PRD 16/04

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 Paymark 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 20(2), 24(3), 24(5), 75(1), 75(2), and 75(3).

The Arrangement to which this Ruling applies

The Arrangement is the use of the Paypr App to upload electronic EFTPOS receipts (e-Receipts) and other information to Xero.

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

Parties

1. The parties to the Arrangement are:
   - Paymark: an electronic payments provider and the operator of the EFTPOS network and the Paypr system and the Paypr App;
   - A card holder: an individual who holds an electronic payment card that is registered with Paypr (Registered Card) and has installed the Paypr App on a mobile device (Card Holder);
   - A merchant: a Paymark client that uses the EFTPOS network to process electronic payments (Merchant);
   - A business customer: a customer that has subscribed to Paypr and uses Xero to retain the customer's accounting records (Business Customer); and
   - Xero: a New Zealand-based software company that develops cloud-based accounting software for small and medium-sized businesses.

Paypr App

2. Paymark has developed e-Receipts as an alternative to the paper receipts currently issued by Merchants.
3. The Paypr App puts a token against the Registered Card in the Paymark system.
4. When a Card Holder pays for goods or services from a Merchant on the Paymark network using a Registered Card (Transaction), the Paymark system will recognise the token as belonging to the Card Holder's Paypr account and will create an e-Receipt using the Transaction data available to Paymark.
5. Paymark will send the e-Receipt, along with data populated into an expense entry, direct to the Paypr App.
6. An e-Receipt will consist of an image that, in appearance, looks like the paper receipt that a Merchant's EFTPOS machine will print for the Transaction.
7. An e-Receipt will contain the following information:

Details on e-Receipt	Field Description
TERM	Terminal ID
TIME	Transaction Date/Timestamp
CREDIT	Account
CARD	Card Mask / token
AMEX	Card Type
PURCHASE	Purchase Total
TOTAL	Transaction Total
NZ	Currency Code
ACCEPTED	Acceptance Confirmation
The Coffee Shop	Merchant Name
++++'EFTPOS'++++	EFTPOS Terminal Data
COPY ONLY	Copy Only

8. An e-Receipt does not include details of the goods and services supplied by the Merchant.
9. Once an e-Receipt has been issued, the Card Holder will select one of two options in relation to the e-Receipt in the Paypr App. The Card Holder can:
   - create an expense entry or claim for uploading to the Business Customer's Xero account, where the transaction is a business-related expense; or
   - discard the e-Receipt, where the transaction is not a business-related expense.
10. Where the Card Holder selects to create an expense entry or claim, the Card Holder enters the following information in the Paypr App in relation to the Transaction (Additional Information):
    - the applicable Xero general ledger code of the Business Customer; and
    - a description of the Transaction, including a description of the goods and services purchased by the Card Holder.
11. For a Transaction of more than $50 (including GST), the Card Holder also takes and uploads to the Paypr App a photograph or photographs of the paper tax invoice issued by the Merchant (Tax

Invoice Photograph). A Tax Invoice Photograph is an electronic image, or a composite electronic image where the Tax Invoice Photograph consists of more than one photograph, of the paper tax invoice issued by the Merchant and contains the following information:

- the words "tax invoice" in a prominent place;
- the name and GST registration number of the Merchant;
- the name and address of the Business Customer (for transactions over $1,000);
- the date on which the tax invoice is issued;
- a description of the goods and services supplied;
- the quantity or volume of the goods and services supplied (for transactions over $1,000); and
- either—
  - the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax, for the supply; or
  - where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in respect of the tax.

12. The Card Holder then submits the Transaction, including the e-Receipt, the Additional Information and the Tax Invoice Photograph (where applicable), to the Business Customer's Xero account.
13. On submission of the Transaction to the Business Customer's Xero account:
    - the Transaction is posted to the applicable Xero general ledger accounts (after approval procedures in Xero have been followed where applicable) (Accounting Entries);
    - the e-Receipt, the Additional Information and, where applicable, the Tax Invoice Photograph (Retained Information) is stored in, and linked to, the Business Customer's Xero account.
14. The Accounting Entries and Retained Information will be retained by Xero for at least seven years.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The information contained in an e-Receipt received and uploaded by a Card Holder, via the Paypr App, to a Business Customer's connected Xero account must remain complete and it must not be possible for the information to be edited or altered in anyway by the Merchant, the Card Holder, the Business Customer or Xero.

b) The image record of an e-Receipt stored in Xero must identify the origin, destination, and the time at which the e-Receipt was sent to, and received by, the relevant Card Holder.

c) The image record of an e-Receipt retained by Xero must be readily accessible for future reference.

d) A Tax Invoice Photograph uploaded to a Business Customer's Xero account must be a legible and complete duplicate image of the original paper tax invoice issued by a Merchant to a Card Holder for a Transaction. The image, or composite image where the Tax Invoice Photograph consists of more than one photograph, must include all of the following:

- the words "tax invoice" in a prominent place;
- the name and GST registration number of the Merchant;
- the name and address of the recipient (for transactions over $1,000);
- the date upon which the tax invoice is issued;
- the quantity or volume of the goods and services supplied (for transactions over $1,000); and
- either:
  - the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax, for the supply; or
  - where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in respect of the tax.

e) The information contained in a Tax Invoice Photograph that is uploaded to a Business Customer's Xero account must remain complete and it must not be possible for the information to be edited or altered in anyway by the Card Holder, the Business Customer or Xero.

f) The image record of a Tax Invoice Photograph stored in a Business Customer's Xero account must identify the time at which the Tax Invoice Photograph was uploaded by a Card Holder to Xero.

g) The image record of a Tax Invoice Photograph retained by Xero must be readily accessible for future reference.

h) The image record of a Tax Invoice Photograph retained by Xero must be readily able to be produced in paper form and that paper form must be a duplicate image of the original paper tax invoice.

How the Taxation Laws apply to the Arrangement

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

a) An e-Receipt uploaded to a Business Customer's Xero account will satisfy the record-keeping requirements in ss 75(2) and 75(3) and the Business Customer will not need to retain the corresponding paper form of the e-Receipt.

b) For a Transaction that does not exceed $50 (including GST), an e-Receipt and the Additional Information for the Transaction uploaded by a Card Holder, via the Paypr App, to a Business Customer's connected Xero account:

- will satisfy the record-keeping requirements in ss 75(2) and 75(3);
- will mean the Business Customer will not need to retain the paper form of the e-Receipt or a paper form of the Additional Information to satisfy the requirements in ss 75(2) and 75(3);
- will be sufficient, for the purposes of s 75(3), to ascertain the Business Customer's tax liability; and
- will be sufficient, for the purposes of s 20(2), to calculate the Business Customer's input tax deduction for the Transaction;

provided that if the Merchant, although not being under a legal obligation to do so, issues a tax invoice for the Transaction, the Business Customer must retain either the tax invoice or a Tax Invoice Photograph uploaded to the Business Customer's connected Xero account.

c) A Tax Invoice Photograph, taken and uploaded by a Card Holder via the Paypr App to a Business Customer's connected Xero account, will satisfy the record-keeping requirements in ss 75(2) and 75(3).

d) To satisfy the record-keeping requirements in ss 75(2) and 75(3), a Business Customer will not need to retain the original paper form of the tax invoice that a Card Holder photographs and uploads, via the Paypr App, as a Tax Invoice Photograph to the Business Customer's connected Xero account.

e) For a Transaction of over $50 (including GST), the e-Receipt, the Additional Information, and the Tax Invoice Photograph for the Transaction uploaded by a Card Holder, via the Paypr App, to a Business Customer's connected Xero account:

- will satisfy the record-keeping requirements in ss 75(2) and 75(3);
- will mean that, for the purposes of ss 75(2) and 75(3), the Business Customer will not need to retain:
  - the paper form of the e-Receipt,
  - a paper form of the Tax Invoice Photograph, or
  - a paper form of the Additional Information;
- will be sufficient, for the purposes of s 75(3), to ascertain the Business Customer's tax liability; and
- will be sufficient, for the purposes of s 20(2), to calculate the Business Customer's input tax deduction for the Transaction.

f) For a Transaction over $50 (including GST), a Tax Invoice Photograph uploaded to a Business Customer's Xero account will satisfy the requirement in s 20(2) that the Business Customer is required to hold a tax invoice for the Transaction at the time of making a deduction for input tax for the Transaction, provided the Tax Invoice Photograph has been uploaded to Xero by the time the Business Customer furnishes a GST return containing the deduction.

This Ruling does not apply to a Transaction over $50 (including GST) where a Card Holder has not uploaded, via the Paypr App, a Tax Invoice Photograph to a Business Customer's connected Xero account.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 31 May 2016 and ending on 31 May 2019.

This Ruling is signed by me on the 31st day of May 2016.

Howard Davis
Director (Taxpayer Rulings)

BINDING RULINGS

NEW LEGISLATION

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

TAXATION (RESIDENTIAL LAND WITHHOLDING TAX, GST ON ONLINE SERVICES, AND STUDENT LOANS) ACT 2016

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill was introduced into Parliament on 16 November 2015. It received its first reading on 8 December 2015, second reading on 31 March 2016 and completed the third reading on 10 May 2016, followed by Royal assent on 13 May 2016.

The new legislation introduces a new withholding tax on sales of residential property by offshore persons who sell the property within two years of acquisition.

The Act also amends the Goods and Services Tax Act 1985, requiring offshore suppliers to register and return GST on the supply of cross-border services and intangibles supplied to New Zealand-resident consumers.

Amendments have also been made to the Student Loan Scheme Act 2011, to allow certain information on student loan borrowers living in Australia to be shared between Inland Revenue and the Australian Taxation Office.

The new Act amends the Income Tax Act 2007, Goods and Services Tax Act 1985, Tax Administration Act 1994 and the Student Loan Scheme Act 2011.

GST ON CROSS-BORDER SUPPLIES OF REMOTE SERVICES

Sections 2, 5(10B), 5(11), 5(13), 5(27), 8(3)(c), 8(4), 8(4B), 8(4D), 8B, 10(14B) to (4F), 11A(1)(j), 11A(1)(x), 11A(7), 15(6), 20(3)(d)(vii), 20(3)(dc), 20(3JC), 20(4C), 20(4D), 24(4), 24(5) to (5D), 24B, 25(1)(aab) to (abb), 25AA, 51(1C), 51B(7), 60(1A), 60(1AB), 60(1C), 60C, 60D, 75(3F), 77 and 85B of the Goods and Services Tax Act 1985; sections 24BA(1B) and 143A(1)(g) of the Tax Administration Act 1994

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016 amends the Goods and Services Tax Act 1985 by applying goods and services tax (GST) to cross-border "remote" services and intangibles supplied by non-resident suppliers to New Zealand-resident consumers.

"Remote" services include e-books, music, videos and software purchased from offshore websites. The new rules will require non-resident suppliers to register and return GST on these supplies if they exceed, or are expected to exceed, NZ$60,000 in a 12-month period.

The new rules apply from 1 October 2016, and non-resident suppliers will be able to apply to be registered from 1 August 2016, with registration taking effect from 1 October 2016. The registration form and information about registering for GST will be located on Inland Revenue's website, **www.ird.govt.nz** (search keywords: non-resident GST). For general enquiries, or to apply for the Commissioner of Inland Revenue to exercise various discretions included in the rules, email **Info.gors@ird.govt.nz**

Background

In principle, GST should apply to all consumption that occurs in New Zealand, as this ensures that the system is fair, efficient and simple.

When GST was introduced in 1986, few New Zealand consumers purchased offshore services, and online digital products were not available. At that time, the compliance and administrative costs that would have been involved in taxing imported services outweighed the benefits of taxation.

The growth of e-commerce means the volume of services and intangibles on which GST has not been collected is increasingly significant. Previous tax settings had the potential to distort consumer and business decisions, placing New Zealand suppliers of services and intangibles at a competitive disadvantage relative to non-resident suppliers. Non-collection of GST on cross-border services and intangibles has also resulted in a growing "hole" in New Zealand's GST revenue base.

The new rules are intended to maintain the broad base of New Zealand's GST system and from a GST perspective create a level playing field between domestic and offshore suppliers of services and intangibles. The effect will be to reduce the extent to which differences in GST treatment distort consumers' purchasing decisions.

The amendments broadly follow Organisation for Economic

Co-operation and Development (OECD) guidelines, as well as similar rules that apply in other jurisdictions, such as Member States of the European Union, Norway, South Korea, Japan, Switzerland and South Africa. Australia also enacted similar rules that will apply from 1 July 2017.

Key features

Scope of the new GST rules

From 1 October 2016, GST will apply to cross-border "remote" services and intangibles supplied by non-resident suppliers to New Zealand-resident consumers. The new rules will require non-resident suppliers to register and return GST on these supplies if the supplies in aggregate exceed, or are expected to exceed, NZ$60,000 in a 12-month period.

Consistent with New Zealand's broad-based GST system, the new rules apply GST to a wide range of cross-border remote services.[1] A "remote" service is defined as a service where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance. The definition includes digital services, such as e-books, music, videos and software downloads, as well as non-digital services, such as general insurance, consulting, accounting and legal services.

The new rules only apply when a remote service is supplied by a non-resident to a New Zealand resident and the service is not physically performed in New Zealand (which is covered by existing rules). Non-resident suppliers will be required to determine whether a customer is a New Zealand resident on the basis of two non-contradictory pieces of commercially available evidence.

The rules contain a list of commercially available evidence that suppliers can rely on, being:

- the person's billing address;
- the internet protocol (IP) address of the device used by the person or another geolocation method;
- the person's bank details, including the account the person uses for payment or the billing address held by the bank;
- the mobile country code (MCC) of the international mobile subscriber identity (IMSI) stored on the subscriber identity module (SIM) card used by the person;
- the location of the person's fixed landline through which the service is supplied to them; and
- other commercially relevant information.

The Commissioner of Inland Revenue will be able to prescribe or agree to an alternative method of determining whether a customer is resident, in circumstances when there is insufficient information available to apply the test. The Commissioner will take into account:

- whether the supply is made in a low-value, high-volume digital context;
- whether the supply is a one-off transaction, rather than one made between a supplier and customer who have an on-going relationship; and
- the information that is commercially available to the supplier.

Remote services supplied to GST-registered businesses

Non-resident suppliers will not be required to return GST on supplies to New Zealand GST-registered businesses, nor will they be required to provide tax invoices. However, the supplier will be able to treat the supply as zero-rated (taxed at a rate of 0%). This may allow the supplier to claim back New Zealand GST costs incurred in making zero-rated supplies to GST-registered businesses.

A rule requires non-resident suppliers to presume that a New Zealand-resident customer is not a GST-registered business unless the customer has provided their GST registration number, New Zealand Business Number or notified the supplier of their status as a registered business. The Commissioner of Inland Revenue is also able to prescribe or agree to an alternative method of determining whether the supply is made to a GST-registered person. The Commissioner will take into account the following matters as an indication that the services are generally only supplied to registered businesses:

- the nature of the supply (for example, advertising services);
- the value of the supply (for example, the provision of a high-value software package that would only be associated with business use);
- the terms and conditions of the provision of services (for example, software that is licensed for enterprise use across a large number of networked computers).

When a GST-registered recipient is inadvertently charged GST, they will have to seek a refund from the non-resident supplier, and the non-resident supplier may make a GST adjustment in their GST return when it is apparent that a mistake has been made. Alternatively, if the payment for the supply (including GST) is NZ$1,000 or less, a non-resident supplier will have the option to provide a tax invoice to the purchaser to allow them to claim a deduction, rather than to refund the GST charged and make the necessary adjustment in their GST return.

[1] Services that are already exempt (such as supplies of financial services), zero-rated under a specific rule or the rules that apply to telecommunication services retain their current treatment under the new rules.

Special rules for certain non-resident suppliers

Non-resident marketplaces

When certain conditions are satisfied, an operator of a marketplace (such as an app store) may be required to register and return GST on supplies made through the marketplace, instead of the underlying supplier.

The rules require the non-resident operator of an "electronic marketplace", rather than the underlying supplier, to register and return GST. An "electronic marketplace" is a marketplace operated by electronic means through which a person (the underlying supplier) makes a supply of remote services by electronic means through another person (the operator of the marketplace) to a third person (the recipient).

Operators of "non-electronic marketplaces" can also register and return GST on behalf of its underlying suppliers (for example, in the insurance industry) but this requires an agreement with the Commissioner of Inland Revenue.

New Zealand agents

A new agency rule provides agents acting for non-resident suppliers of remote services to New Zealand-resident consumers the ability to agree with the supplier to treat the agent (and not the principal) as making the supply.

Insurance and gambling services

General insurance and gambling services are subject to special GST rules that apply GST on a cashflow and net basis:

- Non-resident insurance suppliers will need to return GST on premiums charged to New Zealand-resident consumers and will be able to claim deductions when making insurance payments to New Zealand-resident consumers, or on New Zealand GST costs incurred in paying for replacement goods or repair services.
- Non-resident gambling suppliers will need to return GST on the amounts received from New Zealand residents less amounts paid out to New Zealand residents. A special rule allows losses derived from one taxable period to be used to offset positive amounts from subsequent taxable periods.

Non-double taxation rule

A special rule will prevent double taxation from arising on supplies of remote services performed in New Zealand to a non-resident consumer in situations when the same supply is also subject to consumption tax in another jurisdiction. The rule allows a deduction against the supplier's liability for New Zealand GST to the extent that the same supply has been taxed in another jurisdiction.

Reverse charge (GST-registered recipient of remote services)

The reverse charge has been extended to GST-registered businesses that receive non-taxable supplies of remote services and do not use or intend to use those services to make taxable supplies. The reverse charge applies if the percentage intended or actual taxable use of the services is less than 95 percent of the total use. The reverse charge requires the GST-registered businesses to return the GST. An equivalent reverse charge also applies in relation to zero-rated supplies of remote services received by GST-registered businesses.

Administration of the non-resident registration system

Registration

The new rules will require non-resident suppliers to register and return GST on remote services supplied to New Zealand-resident consumers if these supplies exceed, or are expected to exceed, NZ$60,000 in a 12-month period. Non-resident suppliers are able to use a fair and reasonable method of converting foreign currency amounts to New Zealand currency to determine whether the registration threshold has been exceeded.

Non-resident suppliers are able to apply to be registered from 1 August 2016 (an application form will be available on that date) with the registration coming into force on 1 October 2016. The registration form will be located on the Inland Revenue website **www.ird.govt.nz** (search keywords: non-resident GST). The application form will be relatively simple and ask for the applicant's name, contact details, country of residence (including any existing tax identification numbers), a description of the business activity and website address.

If a non-resident supplier is already registered for GST because they make taxable supplies under the standard rules, they do not need to register separately for any remote services they supply. Instead, these suppliers should continue to file their usual GST returns and include their supplies of remote services.

Filing GST returns

The registration form will ask applicants whether they intend only to return GST, or return GST and claim GST back on New Zealand-based costs. A simplified "pay-only" GST return will be available from 1 April 2017, for suppliers that only return GST. The simplified return would only include fields relevant to returning GST, such as the amount of supplies to New Zealand-resident customers and the amount of GST required to be returned.

Applicants who indicate that they intend to return GST and claim GST may be asked to provide further information about their business during the registration process to better confirm their identity. These applicants will be required to file a full GST return.

Both types of GST return will be able to be filed online using Inland Revenue's myIR. For GST payments, myIR displays payment options available to registrants, such as Western Union and OrbitRemit, and provides links and instructions on how to make payments. Information on how to file returns online and make payments will be available to non-resident suppliers when they apply to register for New Zealand GST.

Taxable periods

For the period from 1 October 2016 to 31 March 2017, non-resident suppliers of remote services will have a taxable period of six months (or an optional taxable period of two months). After this transitional period, these suppliers will have mandatory quarterly taxable periods beginning on 1 April 2017.

A GST return must be provided setting out the tax payable for the taxable period by the 28th of the month following the end of the taxable period. The end of each taxable period is the last day of the month at the end of the taxable period. The quarterly taxable periods end on 30 June, 30 September, 31 December and 31 March.

Converting amounts to New Zealand dollars

When converting to New Zealand dollars for determining the amount of GST required to be returned, the supplier can use the conversion rate at:

- the time of supply;
- the end of each taxable period;
- the time of filing the return (or at the due date for filing, if the return is filed past the due date);
- another time as agreed with the Commissioner of Inland Revenue.

Once the supplier elects in their return to use an option they may not change their method for a period of 24 months, unless they agree otherwise with the Commissioner.

Consumers providing false or misleading information

The Commissioner of Inland Revenue will have the discretion to require a person to register and pay the GST if that person provides false or misleading information about themselves in order to avoid GST, if the GST amount involved is substantial or the behaviour is repeated.

Existing "knowledge offences" rules may also apply when a person deliberately supplies incorrect information to a non-resident supplier for the purpose of avoiding GST by misrepresenting themselves as a registered business or as a resident of another country. This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence, or NZ$50,000 for repeated offences.

Transitional rule

A transitional provision is provided in the new rules for fixed-term contracts entered into before 1 October 2016 and when the consideration for the supply is set or reviewed for periods of 396 days or less during the term of the agreement.

The transitional provision allows suppliers to treat periodic payments under the contract as not being successive supplies, and therefore, payments made after 1 October 2016 are not subject to GST. This transitional rule only applies for the term of the agreement or up to 396 days from the date the contract was entered into, whichever is earlier.

Application date

The new GST rules come into force on 1 October 2016.

Detailed analysis

References are to the Goods and Services Tax Act 1985 unless stated otherwise.

Scope of the new GST rules

Sections 2, 8(3)(c), 8(4D), 8B, 11A(1)(j), 11A(1)(x) and 51(1C)

Place of supply rules

The GST Act imposes GST on goods and services supplied in New Zealand. The Act adopts a broad set of rules to determine whether a good or service is considered to be supplied in New Zealand in the first instance. The place of supply rules are followed by a range of exclusions that determine whether the supply is zero-rated or exempt rather than taxed at the normal 15% rate.

If a non-resident person supplies services, the starting point is that the supply will be treated as having been made outside New Zealand, and therefore not subject to GST. However, under section 8(3)(b), services are treated as having been supplied in New Zealand if the services are physically performed in New Zealand by a person who is in New Zealand at the time of performance. Section 8(4) provides that if a supply is made to a GST-registered business for the purposes of carrying on their taxable activity, the services are considered to be supplied outside New Zealand, and therefore are not subject to GST, unless the parties agree that GST will apply.

New section 8(3)(c) has been inserted into the place of supply rules, which treat supplies of "remote services" (as defined) supplied by a non-resident to a person resident in New Zealand as a supply made in New Zealand. The supply is therefore subject to GST, unless the services are physically performed in New Zealand by a person who is in New Zealand at the time the services are performed (in which case the supply would be subject to GST under existing section 8(3)(b)).

In the same way as section 8(4), new section 8(4D) provides that if remote services are made to a GST-registered business for the purposes of carrying on their taxable activity, the services are treated as having been supplied outside New Zealand. The services are therefore not subject to GST, unless the non-resident supplier chooses to treat the services as being made in New Zealand (no agreement is required between the supplier and recipient for this purpose).

If the supplier chooses to treat the services as being made in New Zealand, these services will be zero-rated under section 11A(1)(x). (See the following section for more information on business-to-business supplies.)

Section 11A(1)(j) zero-rates services that are physically performed outside New Zealand or supplies that arrange services that are physically performed outside New Zealand. An amendment to this section excludes supplies of remote services to a person resident in New Zealand that is not a registered person from this zero-rating rule. This creates a level playing field between resident and non-resident suppliers, as in both cases, GST will apply at the 15% rate when remote services are physically performed outside New Zealand and supplied to a New Zealand-resident consumer.

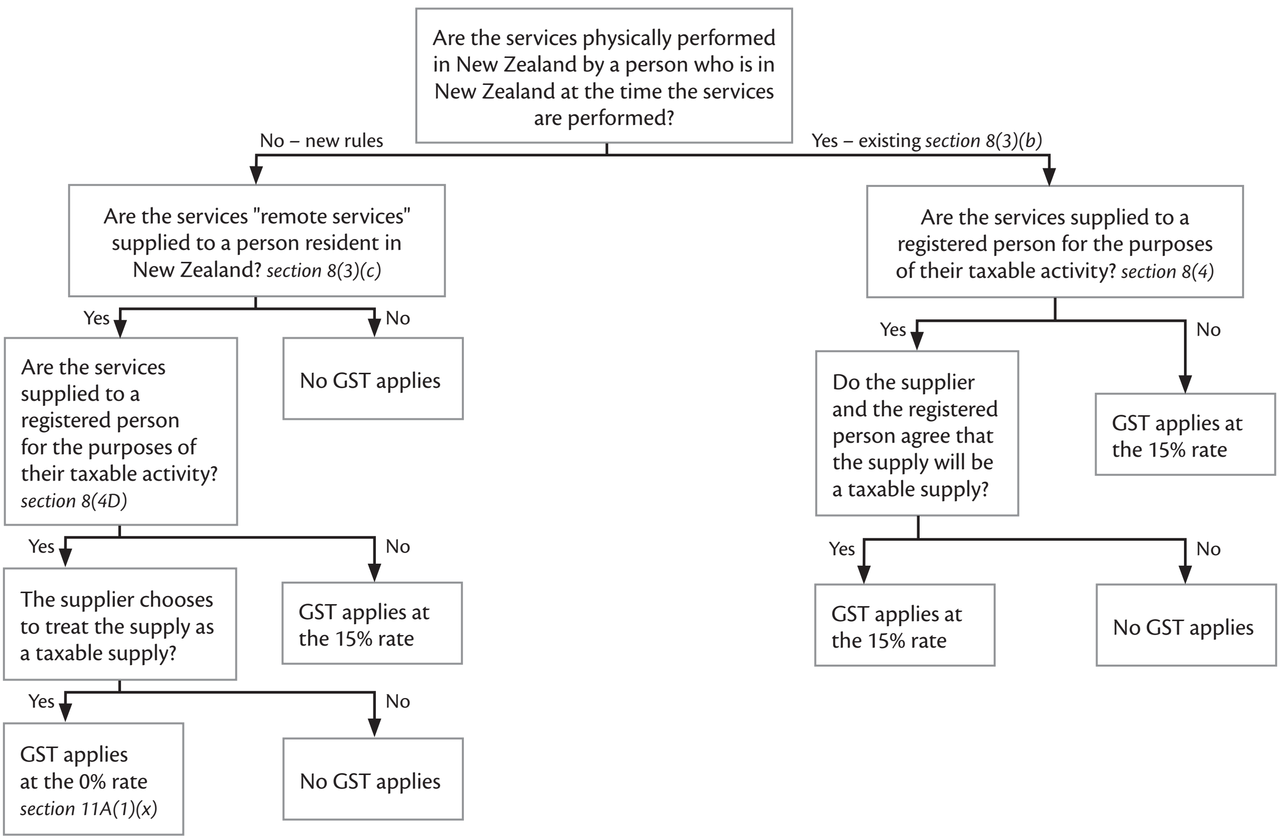
Example

Movie Co. is a non-resident company that provides remote services to consumers in a number of countries, including New Zealand. As some of these services are remote services supplied to a New Zealand-resident consumer, these supplies will be subject to GST under section 8(3)(c). If Movie Co. exceeds the NZ$60,000 registration threshold, it will be required to register and return GST on these supplies.

If Movie Co. was a resident of New Zealand that physically performed remote services outside New Zealand, its supplies would also be subject to GST at the 15% rate when supplied to New Zealand-resident consumers, due to the exception to section 11A(1)(j).

Services that are already exempt (such as supplies of financial services), or zero-rated under a specific rule, would retain that treatment under the new rules.

Summary of the new place of supply rules for services



Definition of "remote services"

Under section 2, "services" are defined to include anything other than goods or money. A definition of "remote services" has been added to section 2, being a service where, at the time of the performance of the service, there is no necessary connection between the physical location of the customer and the place where the services are performed.

Whether a service is a "remote service" will depend on whether the nature of the service requires that the recipient is present when the service is physically performed. If a service is actually, or capable of being supplied when the recipient is not present, the test will be satisfied as there is no necessary connection between the physical location of the recipient and the place of physical performance.

Requiring a connection between the physical location of the customer and the place of physical performance of services means that the definition of "remote services" includes services that are capable of being supplied remotely, but that happen to be provided when the recipient and provider are in the same location.

Examples of services that could be supplied as remote services include:

- supplies of digital content, such as e-books, movies, TV shows, music and online newspaper subscriptions;
- online supplies of games, apps, software and software maintenance;
- webinars or distance learning courses;
- insurance services;
- gambling services;
- website design or publishing services; and
- legal, accounting or consultancy services.

Examples of services that would not be remote services include:

- provision of accommodation;
- hairdressing, beauty therapy and physiotherapy;
- car rental services;
- entry to cinema, theatre performances, sports events and museums;
- gym memberships;
- passenger transport services; and
- restaurant and catering services.

Example

Legal Co. is a non-resident company based in Australia. Sam, a New Zealand tax resident, seeks advice from Legal Co. about investing in an Australian company. The nature of the service is such that Sam is not required to be present when the advice is provided, and in fact the advice is provided via telephone and email, rather than in person.

The services are remote services, as there is no necessary connection between Sam's physical location and the place where the service is physically performed. If Legal Co. exceeds the registration threshold, it will be required to register and return GST on this supply.

An amendment has also been made to the definition of "goods" under section 2. The amendment removes the reference to a non-resident supplier and resident recipient, in order to ensure that intangible digital products will be treated as services irrespective of the tax residence of the supplier and recipient.

Telecommunications services

The GST Act includes special rules for cross-border supplies of telecommunications services,[2] including specific place of supply and zero-rating rules. These rules determine the GST treatment of the supply based on the place that the customer is located when initiating or receiving services.

These rules zero-rate domestic telecommunications providers' supplies of international roaming services to New Zealand residents who are temporarily offshore. Offshore telecommunications providers are, however, required to charge GST on services provided to non-resident consumers that are temporarily in New Zealand (for example, inbound roaming services), if the total value of their supplies exceeds the NZ$60,000 registration threshold. However, if the threshold is exceeded only because of supplies to non-residents that are physically present in New Zealand, they are not required to register.

The new rules are not intended to disturb the current tax settings for telecommunications services. Section 8(5) excludes these services from the application of the relevant provisions.

GST registration threshold

As a result of the changes to the place of supply rules, non-resident suppliers of remote services to New Zealand customers will be required to register for GST if the total value of supplies made in New Zealand exceeds NZ$60,000 in a 12-month period, which is equivalent to the existing registration threshold for resident suppliers.

[2] "Telecommunications services" are defined to include the transmission, emission or reception of information by certain technical systems, including access to global information networks, but excludes the content of the telecommunication.

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As these suppliers will be subject to the rules contained in section 51, non-resident suppliers will be required to register if:

- the total value of their supplies made in New Zealand in the past 12 months exceeded NZ$60,000 (unless the Commissioner of Inland Revenue is satisfied that their supplies in the next 12 months will not exceed this threshold); or
- the total value of their supplies made in New Zealand in the next 12 months is expected to exceed NZ$60,000.

As remote services supplied by a non-resident to a New Zealand GST-registered business are generally treated as not being supplied in New Zealand (and therefore not subject to GST), these supplies will not count towards the registration threshold. However, if the supplier chooses to zero-rate the services they will count towards the threshold.

If a non-resident supplier of remote services is carrying on a taxable activity in New Zealand, and their supplies fall below the NZ$60,000 threshold, they will be able to voluntarily register for GST.

Example

Music Co., a non-resident, supplies access to music on a subscription basis over the internet. Music Co. also supplies licences for businesses such as restaurants and bars to play music in a commercial setting.

Each year, Music Co. makes supplies valued at NZ$50,000 to New Zealand customers who are not GST-registered. It makes supplies valued at NZ$20,000 to New Zealand GST-registered customers.

Unless Music Co. chooses to treat its supplies to GST-registered customers as being zero-rated, Music Co. will not be required to register and return GST on any of its supplies in New Zealand, as it has not exceeded the NZ$60,000 registration threshold.

New section 51(1C) allows non-resident suppliers to use a "fair and reasonable" method of converting foreign currency amounts to New Zealand currency to determine whether the registration threshold has been exceeded. This includes converting amounts to New Zealand currency as at the time of supply, using the current exchange rate at the time of testing the threshold, or using an average exchange rate over the period. Any of these methods would be regarded as fair and reasonable as long as they were used on a consistent basis.

Example

Software Co., a non-resident, supplies software to New Zealand businesses and individual consumers. Over the past two years, Software Co. has supplied NZ$10,000 of software, each month, to New Zealand individual consumers and this is expected to continue into the foreseeable future.

Software Co. will be expected to register for New Zealand GST from 1 October 2016 as it is reasonably expected that their supplies to New Zealand individual consumers will exceed NZ$60,000 in the 12 months following 1 October 2016 (the date the new rules apply from).

Determining whether a customer is resident in New Zealand

When applying the new place of supply rules, a supplier will be able to use objective proxies to determine whether a customer is a New Zealand resident. Under new section 8B(1) and (2), a non-resident supplier of remote services is required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence.

This rule is intended to provide non-resident suppliers with certainty when determining whether a recipient of a supply should be treated as a New Zealand resident. New section 8B(2) provides a list of indicators that can be used for these purposes:

- the person's billing address;
- the internet protocol (IP) address of the device used by the person or another geolocation method;
- the person's bank details, including the account the person uses for payment or the billing address held by the bank;
- the mobile country code (MCC) of the international mobile subscriber identity (IMSI) stored on the subscriber identity module (SIM) card used by the person;
- the location of the person's fixed landline through which the service is supplied to them; or
- other commercially relevant information.

The supplier can use one or more pieces of other commercially relevant information to determine whether a person is resident in New Zealand, rather than using the specific indicators listed. This information might include the customer's trading history (such as the previous billing address of the customer) or the product purchased if it is linked to a geographic location (for example, some vouchers may only be used in a particular country). Information provided by a third party, such as by a payment service provider, can also be used if it is commercially relevant.

Under section 8B(3)(a), if a supplier has more than two sets of evidence that meet the test, where one set supports the conclusion that the customer is resident in New Zealand and another supports the conclusion that the customer is resident in another country, the supplier is required to choose the more reliable set of evidence. Which items are more reliable will depend on the circumstances.

Example

Jacob, a New Zealand tax resident, purchases a navigational app on his phone while on holiday in the United States. The app store collects two pieces of evidence that support the conclusion that Jacob is resident in New Zealand – his credit card information and the records of his billing addresses from his transaction history with the app store.

The app store also has two pieces of evidence that suggest Jacob is resident in the United States – the SIM card in the phone he is using and his IP address. Section 8B(3)(a) requires the app store to use the set of evidence that is more reliable to determine whether GST applies in New Zealand.

The app store has implemented system rules that give priority to its customers' credit card information and transaction history, as these indicators are more reliable in the context of their business. On this basis, the app store treats Jacob as a New Zealand resident, and charges New Zealand GST on the supply.

For additional flexibility, section 8B(3)(b) allows the Commissioner of Inland Revenue to prescribe or agree with a supplier an alternative method of determining whether a customer is resident in New Zealand when sufficient information is not commercially available to apply the test.

Section 8B(3B) outlines a number of factors the Commissioner would take into account when exercising the discretion, being:

- whether the supply is made in a low-value, high-volume digital context;
- whether the supply is a one-off transaction, as opposed to one made where the supplier and customer have an on-going relationship; and
- the information that is commercially available to the supplier.

Remote services supplied to GST-registered businesses

Sections 8(4D), 8B, 11A(1)(x), 11A(7), 20(4C), 24 and 25(1)(aab) to (abb)

New section 8(4D) will apply to supplies made under section 8(3)(c), so that remote services supplied to GST-registered businesses will be treated as being supplied outside New Zealand, unless the supplier chooses to treat the supply as being made in New Zealand. If the supplier chooses to treat the supply as being made in New Zealand, the supply will be zero-rated under new section 11A(1)(x).

Example

Accommodation Co. is a non-resident company that provides facilitation services, by matching customers who are looking for accommodation in a particular location with local accommodation providers.

The facilitation services provided by Accommodation Co. to the local accommodation providers are remote services, as there is no necessary connection between the location of the recipients and the place where the facilitation services are performed.

If the local providers are not registered for GST, these supplies will be subject to GST under section 8(3)(c), as the facilitation services are remote services that are supplied to a New Zealand resident who is not a GST-registered business.

If the local providers are registered for GST, then under section 8(4D) the facilitation services will be treated as being supplied outside New Zealand. If Accommodation Co. incurs New Zealand GST costs, it may wish to zero-rate the services, as this would allow them to deduct the costs incurred in New Zealand in making the supplies.

New section 8B(5) requires non-resident suppliers to treat their services as being supplied to a consumer who is not GST registered, unless the recipient notifies the supplier that they are GST registered or provides their GST registration number or a New Zealand business number. GST-registered recipients of remote services may not identify themselves as a GST-registered business, or provide their GST registration number or a New Zealand business number, if they intend to use the service wholly for non-taxable purposes.

It is recognised that it may not be practical for all suppliers to ask for evidence that a customer is GST-registered. Therefore, to provide additional flexibility, section 8B(6) allows the Commissioner of Inland Revenue to prescribe or agree an alternative method to determine whether the supply is made to a GST-registered person. Section 8B(7) outlines the factors that the Commissioner will consider when exercising the discretion, being:

- the nature of the supply (for example, advertising services);
- the value of the supply (for example, provision of a high-value software package that would only be associated with business use); or
- the terms and conditions of the provision of services (for example, software that is licensed for enterprise use across a large number of networked computers).

Example

Software Co. is a non-resident that provides software to New Zealand businesses and individual consumers. Factors such as price, and licensing terms and conditions mean there is a clear division between the software purchased by businesses and individual consumers. Businesses that purchase the software are likely to be GST-registered businesses.

Software Co. has a large number of customers and it is impractical to ask for evidence to identify their customers as GST-registered. Software Co. is able to apply to the Commissioner of Inland Revenue to use an alternative method for identifying whether their customers are GST-registered persons.

Evidence such as the nature of the products, pricing, licensing terms and other conditions could be used, as well as a sample of their customer base that supports the likelihood that future customers will be GST-registered.

GST inadvertently charged to a GST-registered recipient

There may be instances when a non-resident supplier inadvertently treats a GST-registered business as an individual consumer and therefore charges the business GST. In this situation, the GST-registered recipient should seek a refund from the non-resident supplier and not claim an input tax deduction for the inadvertently charged GST (see the deduction prohibition in section 20(4C)). There is, however, an exception to the deduction prohibition for supplies under NZ$1,000.

Amendments to section 25(1) will allow a supplier to make adjustments to the payment of output tax in the return in which it is apparent that the mistake has been made. This will apply if the supply is standard-rated when it should not have been treated as a taxable supply (see new subsection 25(1)(aab)), or the supply is standard-rated if it should have been zero-rated (see new subsection 25(1)(abb)).

Note that an adjustment will be required only if the non-resident supplier has already furnished a return and has accounted for an incorrect amount of output tax as a result of the mistake (see existing section 25(1)(e)). If the mistake becomes apparent before the relevant return has been furnished, the mistake can be rectified before the return is filed.

Since non-resident suppliers are not required to provide a tax invoice under the amendment to section 24(5), they will not be required to issue a credit note under section 25(4).

Supplies of NZ$1,000 or less

An exception to the above rules applies when the payment for the supply (including GST) is NZ$1,000 or less based on the value of the supply in New Zealand dollars at the time of supply. In this situation, when the supplier inadvertently charges a GST-registered business GST, the supplier can choose to provide a tax invoice to the GST-registered business. This option is intended to be a compliance cost-saving measure for non-resident suppliers in relation to low-value supplies, when the cost of issuing a refund may exceed the cost of issuing a tax invoice. Note that if the supplier chooses to provide a tax invoice, the supplier must provide a full tax invoice, even if the payment for the supply (including GST) is less than $50 (see the amendments to section 24(4)).

The tax invoice must be a full invoice as set out in section 24(3), and therefore must contain the following particulars:

- the words "tax invoice" in a prominent place;
- the name and registration number of the supplier;
- the name and address of the recipient;
- the date upon which the tax invoice is issued;
- a description of the services supplied;
- the quantity of the services supplied;

and either—

- the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax for the supply; or
- where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in relation to the tax.

The exception to the deduction prohibition (discussed above, under section 20(4C)) allows the GST-registered business to claim an input tax deduction under the normal deduction provisions to the extent to which the services are used for, or available for use, in making taxable supplies.

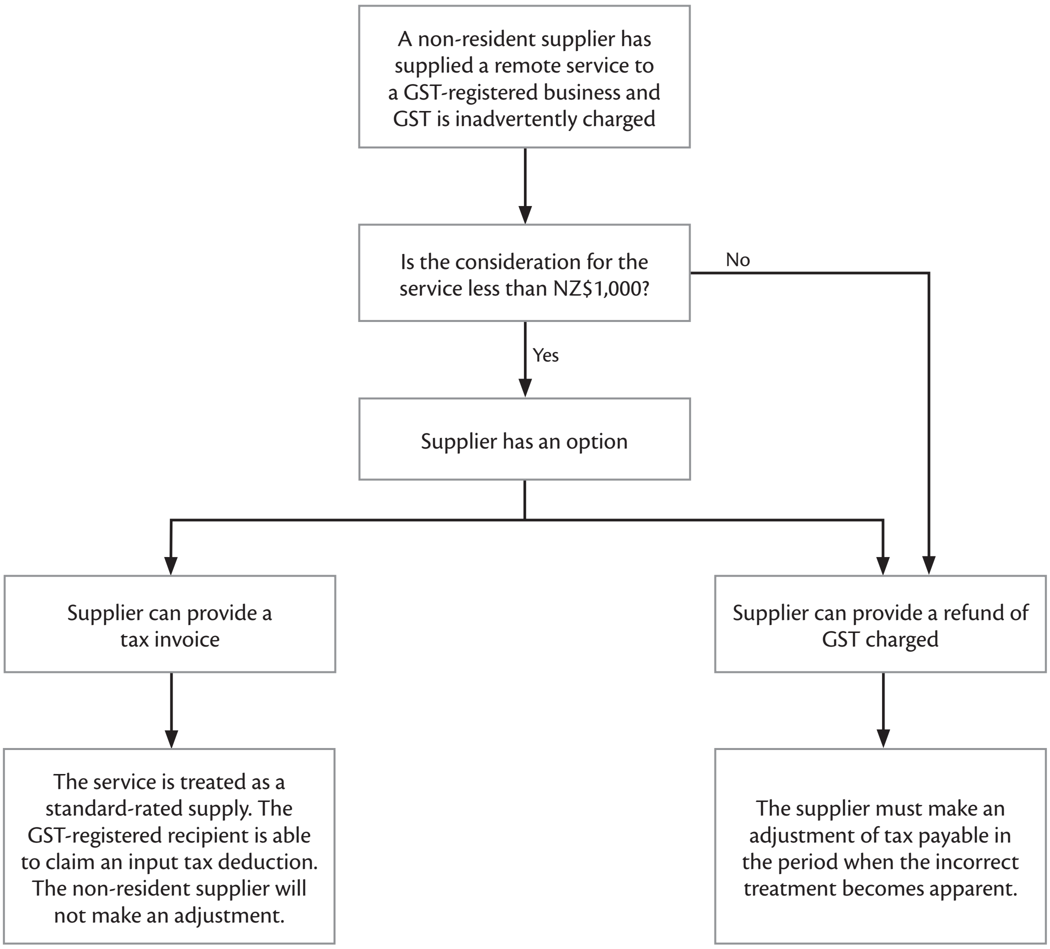
If the supplier chooses to provide a tax invoice:

- the supplier is not required to make an adjustment under section 25 to correct the amount of GST shown on the invoice (see section 25(1)(aab)(ii) and exception to section 25(1)(abb));
- the supplier and recipient are treated as having agreed that the supply is made in New Zealand (and therefore subject to GST) under section 8(4);[3] and
- the zero-rating provision under section 11A(1)(x) does not apply (see exception to the zero-rating provision under section 11A(7)).

These provisions turn a supply that should not have been taxed or was taxed at 0%, into a supply that is taxed at the standard rate of 15%. In this situation, the correct amount of GST is returned by the supplier and therefore an adjustment to the supplier's GST return, under section 25, is not required.

The following diagram summarises how these rules will apply.

When GST is incorrectly charged



[3] Note that new section 24(5B) and (5D) incorrectly refer to section 8(4), instead these sections should refer to new section 8(4D). Officials will seek to correct this cross-referencing error in a future omnibus tax bill.

The option to provide a tax invoice is not available for the supply of a contract of insurance (see section 24(5C) and the discussion on the special rules that apply to contracts of insurance).

Special rules for certain non-resident suppliers

Sections 2, 5(10B), 5(11), 5(13), 10(14B) to (4F), 20(3)(d)(vii), 60(1A), 60(1AB), 60(1C), 60C and 60D

Non-resident marketplaces

A marketplace is a medium that allows consumers and suppliers of goods and services to interact to facilitate the sale and purchase of the goods and services. When certain conditions are satisfied, an operator of a marketplace (such as an app store) instead of the underlying supplier may be required to register and return GST on supplies made through the marketplace. Under the new rules, electronic marketplaces are required to register and return GST, and non-electronic marketplaces can register subject to the Commissioner of Inland Revenue's approval.

The definition of "marketplace" in section 2 means an electronic marketplace or a marketplace approved under section 60D as a supplier of remote services. An electronic marketplace is further defined under section 2 as requiring the following:

- the marketplace allows underlying suppliers to make supplies of remote services through the marketplace to customers;
- the marketplace must be operated by electronic means, including by a website, internet portal, gateway, store, distribution platform or other similar marketplace; and
- the supplies made by the marketplace must be made by electronic means.

Payment providers are excluded from the definition of "electronic marketplace" as these providers merely facilitate the exchange of money between the supplier and consumer, rather than the exchange of the remote service itself.

Electronic marketplace rule

New section 60C states that when a supply of remote services is made through a non-resident operator of an electronic marketplace to a person resident in New Zealand, the operator of the marketplace will be treated as making the supply in the course or furtherance of their taxable activity. As the rules will only apply to non-resident operators of electronic marketplaces through which supplies of remote services are made to New Zealand residents, this rule is not expected to affect existing arrangements that apply in the domestic context.

However, the operator of the electronic marketplace will not be considered to have made the supply if they do not control any of the key elements of the supply, and the liability of the underlying supplier is made clear in the documentation relating to the transaction. Accordingly, under section 60C, the non-resident operator of an electronic marketplace will be the supplier, unless all of the following conditions are satisfied:

- the electronic marketplace does not authorise the charge to the recipient, or authorise the delivery of the supply, or set the terms and conditions under which the supply is made;
- the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace; and
- the underlying supplier and the operator of the marketplace have agreed that the supplier is liable for GST.

If they are treated as making the supply, the operator of the electronic marketplace will be responsible for returning GST. The operator of the electronic marketplace will include these supplies in their turnover for the purpose of determining whether the registration threshold is exceeded and, if it is exceeded, will be liable for the GST.

Non-electronic marketplace rule

Similarly to the rule that applies to electronic marketplaces, new section 60D allows non-electronic marketplaces (such as a syndicate providing insurance services to New Zealand residents) to register as a marketplace subject to the Commissioner of Inland Revenue's approval. The operator, and not the underlying supplier, would then be treated as making the supply in the course or furtherance of a taxable activity.

When exercising this discretion the Commissioner of Inland Revenue may take into account (under section 60D(3)):

- whether the marketplace is best placed to determine whether the recipient of the supply of remote services;
  - is resident in New Zealand;
  - is a registered person; and
- whether the number of underlying suppliers to the marketplace means that return requirements are better satisfied by the marketplace rather than the individual underlying suppliers.

Resident underlying suppliers

A specific rule in new section 60(1C) will apply to New Zealand-resident suppliers of remote services through a marketplace. These underlying suppliers may already be registered for GST under the standard rules. If these suppliers were subject to the general rule under section 60C or 60D, the services they supply through the electronic marketplace would no longer be taxable, as the operator of the marketplace will have been treated as the supplier. This would mean that GST incurred by the underlying supplier in making these supplies would be irrecoverable.

To address this issue, section 60(1C) treats the supply of remote services as two separate supplies – a supply of services from the underlying supplier to the operator, and a supply of those services from the operator of the marketplace to the recipient. This will allow the resident underlying supplier to recover the GST costs incurred in making the supply.

Example

Gaming Co., a New Zealand GST-registered app developer, contracts with Applications Co., a non-resident operator of an app store, to distribute its smartphone games. Applications Co. collects payments from customers and authorises delivery of the app.

Applications Co. is treated as the supplier under section 60C, and therefore is responsible for GST on the supply. If Applications Co. makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of the remote services that are made through it to New Zealand-resident consumers.

Even though Applications Co. is treated as a supplier of the app under section 60C, under section 60(1C), Gaming Co. and Applications Co. can agree to treat the supply from Gaming Co. to Applications Co. as a separate supply. This will allow Gaming Co. to deduct its GST costs incurred in making supplies to Applications Co.

New Zealand-resident agents

A new agency rule under section 60(1A) and 60(1AB) allows agents acting for non-resident suppliers that supply remote services to New Zealand-resident consumers to agree with the supplier to treat the agent (and not the principal) as making the supply in the course and furtherance of a taxable activity carried on by them.

If this option is exercised, the agent would be required to register and return GST on the supplies of remote services. Since the agent is a New Zealand resident they would be treated as any other resident supplier of services and, therefore, would be required to return GST on both supplies to New Zealand consumers and GST-registered businesses.

Example

Agent Co., a New Zealand resident, provides contracts of general insurance to New Zealand residents on behalf of Insurance Co., a non-resident supplier of insurance services. Agent Co. and Insurance Co. agree that Agent Co. will be treated as making the supply of the insurance services.

Assuming the supplies made by Agent Co. exceed the NZ$60,000 registration threshold, Agent Co is now required to register and return GST on behalf of Insurance Co. in relation to supplies to both New Zealand consumers and GST-registered businesses.

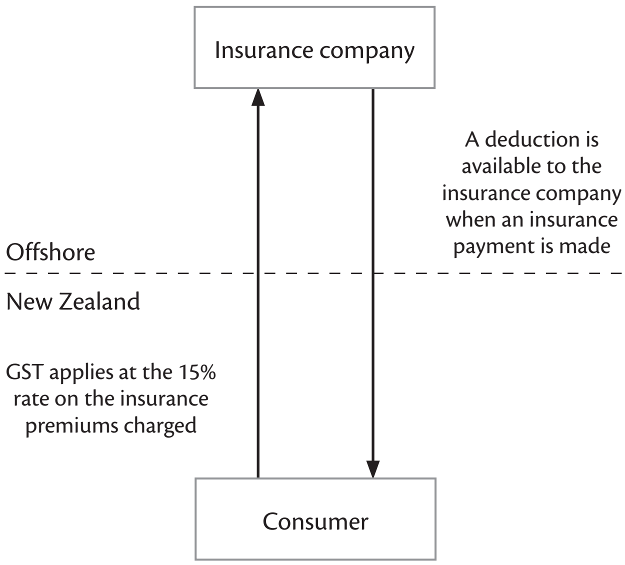
Remote supplies of insurance services

Under the new rules, a non-resident provider of insurance will be required to return GST on premiums charged to New Zealand-resident consumers if its supplies to New Zealand residents exceed the registration threshold, as the supply of the contract of insurance will be taxable under section 8(3)(c).

If registered, a non-resident insurer would also be able to claim a deduction when making an insurance payment under an insurance contract with a New Zealand-resident consumer (through existing section 20(3)(d)), or on New Zealand GST costs incurred in paying for replacement goods or repair services.

The following diagram shows how the rules will apply to cross-border supplies of insurance to New Zealand residents who are not GST-registered businesses.

Cross-border supplies of general insurance services to New Zealand-resident non GST-registered consumers

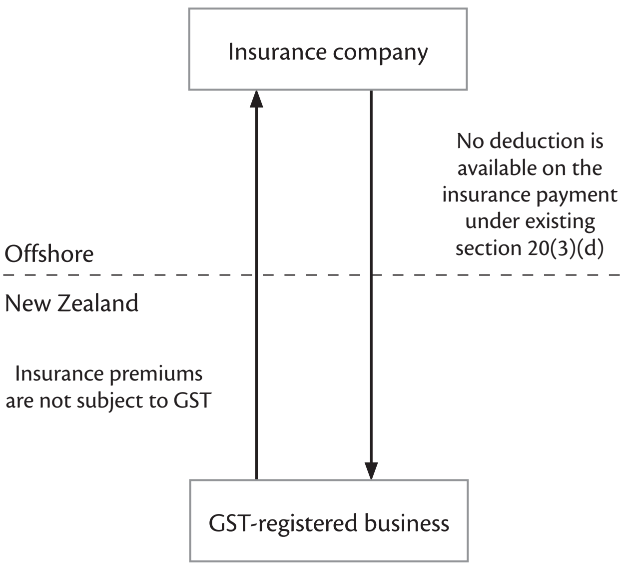


Supplies of general insurance services to New Zealand GST-registered businesses

Unless the insurer decides to zero-rate the supply under sections 8(4D) and 11A(1)(x), cross-border supplies of insurance services to a GST-registered businesses will not be subject to GST.

Consequently, a non-resident insurer will not be required to return GST on premiums charged to GST-registered business customers, and will not be entitled to a deduction under section 20(3)(d). A GST-registered recipient of an insurance payment will not be required to return output tax on the payment under existing section 5(13). This means the current arrangements for GST on supplies of insurance services by a non-resident insurer to a GST-registered business will not change. The following diagram shows how the new rules will apply.

Cross-border supplies of insurance services to New Zealand GST-registered businesses (when the supply is not zero-rated)

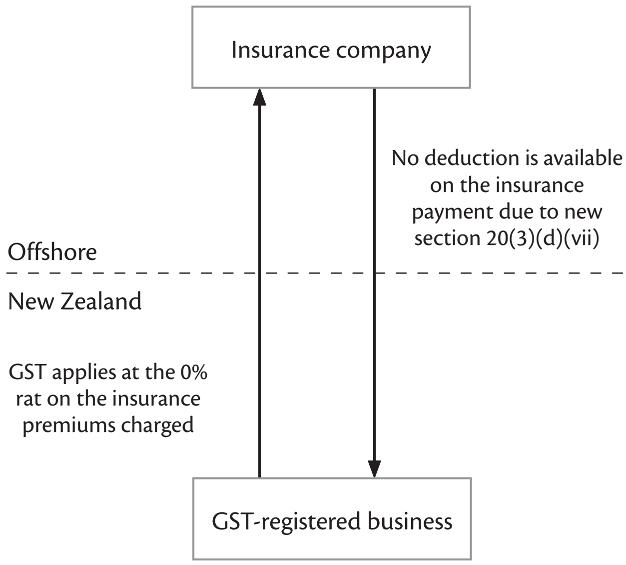


No deemed supply when the business receives an insurance payment under existing section 5(13)

If the non-resident insurer decides to treat the supply as zero-rated, GST will apply at 0% on the insurance premiums. This will allow the insurance supplier to claim back GST costs incurred in New Zealand in making these supplies, which could include costs incurred in repairing or replacing goods. This should mean that non-resident insurers, in the same way as resident insurers, are indifferent from a GST perspective about whether they make a payment to the insured GST-registered business or replace or repair damaged goods.

However, the new rules ensure that an insurer is not entitled to claim a deduction for insurance payments under these contracts (new section 20(3)(d)(vii)), and that a GST-registered recipient of an insurance payment is not required to pay output tax under new section 5(13)(d). This treatment is equivalent to situations when the supply is treated as being made outside of New Zealand, with the exception of the non-resident insurer's ability to claim back related New Zealand GST costs. The following diagram shows how these rules will apply.

Cross-border supplies of zero-rated insurance services to New Zealand GST-registered businesses



No deemed supply when the business receives an insurance payment due to new section 5(13)(d)

No option to provide a tax invoice

The option to provide a tax invoice when GST is inadvertently charged on a supply for consideration of NZ$1,000 or less will not apply to supplies under a contract of insurance. Allowing this option would require changes to ensure that GST applies correctly on a cashflow basis, which would lead to significant complexity in the rules. Because of the nature of insurance services, an insurance company is likely to have access to sufficient information to determine whether their client is a GST-registered business.

Remote supplies of gambling services

New section 5(10B) treats payments for remote gambling services or prize competitions by a New Zealand resident performed outside New Zealand as payment for the supply of services by the person who conducts the gambling or prize competition. An addition to section 5(11) will apply the definition of "gambling" under the Gambling Act 2003 to section 5(10B).

"Gambling" is defined under the Gambling Act 2003 as follows:

- paying or staking consideration, directly or indirectly, on the outcome of something seeking to win money when the outcome depends wholly or partly on chance;
- includes a sales promotion scheme;
- includes bookmaking; and
- includes betting, paying, or staking consideration on the outcome of a sporting event.

A "prize competition" is defined in the GST Act as a scheme or competition:

- for which direct or indirect consideration is paid to a person for conducting the scheme or competition;
- that distributes prizes of money or in which participants seek to win money; and
- for which the result is determined:
  - by the performance of the participant of an activity of a kind that may be performed more readily by a participant possessing or exercising some knowledge or skill; or
  - partly by chance and partly by the performance of an activity as described above, whether or not it may also be performed successfully by chance.

Section 10(14B) applies to determine the consideration for the supply of remote gambling services or prize competitions for the purposes of section 5(10B). The amount of consideration is:

$$\textit{Consideration} = \begin{array}{l}\textit{amounts received}\\ \textit{from residents}\end{array} - \begin{array}{l}\textit{prizes paid to}\\ \textit{residents}\end{array}$$

Amounts received by residents and prizes paid to residents are defined under section 10(14C) as follows:

- *amounts received from residents* – this is the total amount in money received in relation to the supply by the non-resident person who conducts the gambling or the prize competition, as applicable, from all persons resident in New Zealand; and
- *prizes paid to residents* – this is the total amount of all prizes paid and payable in money to persons resident in New Zealand in relation to the supply.

Sections 10(14D), 10(14E) and 10(14F) apply in situations when a loss is calculated under the formula. Losses derived from the formula can be carried forward to the next taxable period and can be offset against positive consideration in that period. Any balance of losses can continue to be carried forward in subsequent periods until they are extinguished.

Example

Gambling Co. operates an offshore gambling website. In a taxable period Gambling Co. receives $100 from New Zealand residents and pays out $250 in prizes to New Zealand residents. Therefore, Gambling Co. has a loss of $150 in that period and will have no GST to return.

In the next taxable period, Gambling Co. receives $500 from New Zealand residents and pays out $120 of prizes to New Zealand residents. Gambling Co. can use the $150 loss from the previous taxable period and offset that loss against the positive consideration calculated in the current period. Therefore, the total consideration derived in the current period is $230 and Gambling Co. will be required to return $30 of GST (($500 – $120 – $150) × (3÷23) = $30).

Non-double taxation rule

Section 20(3)(dc)

Section 20(3)(dc) prevents double taxation from arising on supplies of remote services to a non-resident consumer in New Zealand that are physically performed in New Zealand, by allowing a deduction that offsets their liability for GST in New Zealand to the extent that the supply is subject to consumption tax in another jurisdiction.

Section 20(3)(dc) provides a deduction for the New Zealand GST charged when:

- there is a supply of remote services that are physically performed in New Zealand and supplied to a non-resident person in New Zealand who is not registered for New Zealand GST; and
- the supplier has, in relation to the supply, incurred liability for, returned and paid a consumption tax in another jurisdiction.

The deduction is limited to the GST paid on the supply in New Zealand (15%) and to the extent tax is paid and returned in the other country.

Example

A resident of Country A visiting New Zealand receives a remote service from a New Zealand supplier. The service is physically performed in New Zealand and therefore is subject to New Zealand GST. Country A also requires the New Zealand supplier to register for GST and tax the service at a rate of 20% as it is a remote service supplied to a resident of their country.

The non-double taxation rule allows the New Zealand supplier the ability to claim an input tax credit up to the amount of New Zealand GST returned on the supply (15%) if the supplier has returned and paid GST to Country A. If Country A's tax rate was 10%, the supplier would only be entitled to an input tax credit of 10%.

Reverse charge (GST-registered recipient of remote services)

Sections 8(4B), 20(4D), 20(3JC) and 25AA

An amendment to the reverse charge rule in section 8(4B) will require recipients of a remote service under new section 8(3)(c), that are not treated as being supplied in New Zealand, to return output tax on the supply if the percentage intended or actual use of the services is less than 95 percent of the total use.

An exception (new section 20(4D)) to the prohibition on input tax deductions (new section 20(4C)) allows a recipient of remote services, that is required to return output tax under the reverse charge, to claim an input tax deduction to the extent to which the services are used for, or available for use, in making taxable supplies.

Example 1

Melissa is a self-employed project manager who is registered for GST. She purchases a software package from a non-resident supplier for $400, identifies herself as a GST-registered person and therefore is not charged GST. She uses the software 50 percent for her taxable project management services and 50 percent for home/recreational use.

Under the reverse charge rule, Melissa is treated as making a supply to herself of $400 at the 15% rate. She must return output tax of $60 ($400 × 15%). However, Melissa can claim an input deduction for the portion of the value of the software package (50 percent) that is attributed to her taxable use. This input tax deduction is $30 ($60 × 50 percent). Her net position in the relevant return (assuming no other supplies) is therefore an output tax liability of $30 ($60 output tax minus $30 input tax).

If Melissa's taxable use of the software package had been 95 percent or more, she would not have been required to apply the reverse charge.

The existing reverse charge rule only applies when the supply of services is not treated as a supply made in New Zealand. Therefore, the reverse charge under section 8(4B) will not apply when the non-resident supplier chooses to treat the service as being made in New Zealand under section 8(4D), as the service will be zero-rated under section 11A(1)(x).

In this situation, section 20(3JC) requires the recipient of a remote service under section 8(3)(c), that is zero-rated under new section 11A(1)(x) or existing section 11A(1)(j), to return output tax on the nominal GST component for any non-taxable use of the services. The nominal GST component is the tax that would be chargeable on the value of the supply, as if the value were equal to the consideration charged on the supply.

This section will only apply when at the time of acquisition, or at the end of an adjustment period, the taxable use of the service is less than 95 percent. This is consistent with the application of the reverse charge rule under section 8(4B).

Example 2

The supplier in Example 1 chooses to treat the service as a supply made in New Zealand, in which case the service is zero-rated under section 11A(1)(x). Because the supply is zero-rated, Melissa will be required to return output tax on the nominal GST component for any non-taxable use of the services under section 20(3JC).

Since the value of the software is $400, the nominal GST component is $60 ($400 × 15%). The amount of output tax Melissa is required to return is $30, calculated by multiplying the nominal GST component ($60) by the non-taxable use of the service (50 percent).

Note that an equivalent amount of tax is paid on the services as with the application of section 8(4B).

Amendments have also been made to existing sections 10(15C) (reduction of value of related party internal charges), 24B (records to be kept by recipient of imported services), and 56B (branches and divisions in relation to certain imported services) to ensure these provisions apply when the recipient is required to apply the reverse charge under section 20(3JC).

Reverse charge for supplies of NZ$1,000 or less

There may be instances when a GST-registered recipient applies the reverse charge and the non-resident supplier also inadvertently charges the GST-registered recipient GST. In this situation, GST may be returned twice on a single supply (by the non-resident supplier and the GST-registered recipient). This issue will likely be resolved if the non-resident supplier subsequently returns the GST to the GST-registered recipient and makes an adjustment under section 25 as described previously. An adjustment may still be necessary under section 25AA(1)(a)(iii), however, to ensure the correct amount of tax is accounted for under the section 8(4B) reverse charge rule.

To ensure the correct amount of tax is paid when the supplier provides a tax invoice under section 24(5B), an addition to section 25AA will allow the GST-registered recipient to correct the amount of output tax paid and deductions claimed as a result of the application of the reverse charge rule under section 8(4B). The recipient will then be able to claim, in the normal manner, the portion of the GST charged by the non-resident supplier to the extent to which the services are used for, or available for use in, making taxable supplies.

Example 3

Consider Example 1 again, where Melissa has applied the reverse charge under section 8(4B). However, she subsequently finds out that the price for the software included GST at the standard 15% rate (3 ÷ 23 × $400 = $52.17).

Melissa contacts the non-resident supplier and seeks a refund for the incorrectly charged GST. Instead of providing a refund, since the consideration for the supply is NZ$1,000 or less, the supplier issues Melissa with a full tax invoice.

The tax invoice enables Melissa to claim an input tax deduction to the extent the services are used for, or available for use, in making taxable supplies, which means she can deduct $30. The non-resident supplier is not required to make any adjustments under section 25.

Under section 25AA(1)(a)(v), Melissa makes an adjustment in the return during which it is apparent that a mistake has been made to the amount of output tax and deductions claimed as a result of the application of section 8(4B). Melissa can claim a deduction under section 20(3) for the output tax actually accounted for ($60 under section 25AA(2)) and return output tax for the deduction actually claimed ($30 under section 25AA(3)).

Administration of the non-resident supplier registration system

Sections 5(27), 15(6), 51B(7), 75(3F) and 77 of the Goods and Services Tax Act 1985. Sections 24BA(1B) and 143A(1)(g) of the Tax Administration Act 1994

Taxable periods

For the period beginning 1 October 2016 to 31 March 2017, non-resident suppliers of remote services will have a taxable period of six months, or the option of two-month periods. From 1 April 2017, non-resident suppliers of remote services that are subject to GST under the new rules will have quarterly taxable periods (section 15(6)). This is intended to align with these suppliers' filing obligations in other jurisdictions.

Expressing amounts in a foreign currency

Generally, the GST Act requires all amounts to be expressed in New Zealand currency at the time of supply. This means that if a supply is paid for in a foreign currency, the value of the supply must be expressed as the amount of foreign currency converted to New Zealand currency at the exchange rate applying at the time of supply.

Amendments have been made to section 77 that will provide non-resident suppliers of remote services with a range of options for expressing amounts in a foreign currency.

When converting to New Zealand dollars for determining the amount of GST required to be returned, the supplier can use the conversion rate at:

- the time of supply;
- the end of each taxable period;
- the time of filing the return (or at the due date for filing, if the return is filed past the due date);
- another time as agreed with the Commissioner of Inland Revenue.

Once the supplier elects in their return to use an option other than expressing amounts in New Zealand currency at time of supply, they may not change their method for a period of 24 months, unless they agree otherwise with the Commissioner.

Holding records outside New Zealand and in a language other than English

Currently, a GST-registered person must apply to the Commissioner of Inland Revenue for authorisation to keep records at a place outside New Zealand or in a language other than English. Section 75(3F) provides an automatic exception to this requirement for non-resident suppliers of remote services that are subject to GST under section 8(3)(c).

Exception from the bank account requirement

Recent amendments to the Tax Administration Act 1994 require an offshore person to have a New Zealand bank account in order to obtain an IRD number. This is to ensure that an offshore person has first been subject to New Zealand's anti-money laundering and Countering Financing of Terrorism rules.

Section 24BA(1B) provides an exception to this requirement for non-resident suppliers who require an IRD number solely because they are a non-resident supplier under the GST Act.

Misrepresentations by recipients of remote services

Sections 5(27) and 51B(7) provide a discretion for the Commissioner of Inland Revenue to require a person to register and pay GST that should have been charged, when:

- the person has knowingly provided information that is altered, false or misleading, which leads to a supply being treated as zero-rated or as not being supplied in New Zealand; and
- the person has repeatedly and knowingly provided altered, false or misleading information, or the amount of GST that was not charged is substantial.

The existing "knowledge offences" also apply when a person deliberately supplies incorrect information for the purpose of avoiding GST by misrepresenting themselves as a registered business or as a resident of another country (section 143A(g) of the Tax Administration Act 1994). This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence or NZ$50,000 for repeated offences.

If a customer has provided incorrect or false information to access content that is geographically restricted, and this consequentially results in GST not being charged, the reverse charge rule in section 5(27) and the existing knowledge offences would not be expected to apply. However, there may be other consequences unrelated to New Zealand's tax obligations.

Example

Luke purchases a number of remote services online, including online dating services, music and movie content. Luke is not registered for GST. To avoid paying GST, Luke continually informs suppliers he is GST registered and provides suppliers with a false GST registration number.

The Commissioner of Inland Revenue exercises her discretion to register Luke from the time the services were physically performed, and requires him to repay the GST that was not charged, plus penalties and interest.

Transitional rule

Section 85B

Section 85B contains a new transitional provision similar to the transitional rule under section 78AA(10) and (11), which was provided for the GST rate change in 2010. The new transitional provision applies:

- to contracts that are for a fixed term and entered into before 1 October 2016; and
- to periodic payments made under the contract, and consequently section 9(3)(a) would apply to treat these payments as successive supplies; and
- if the consideration for the supply is set or reviewed for periods of 396 days or less during the term of the agreement (this covers contracts that are entered into during a month and end a year later at the end of the month); and

- if the non-resident supplier elects that the transitional provision applies.

The transitional provision allows a non-resident supplier to treat periodic payments under the contract as not being successively supplied under section 9(3), and therefore, those payments made after 1 October 2016 would not be subject to GST. This transitional rule would only apply for the term of the agreement or up to 396 days from the date the contract was entered into, whichever is earlier. After that time, section 9(3) would usually apply and treat periodic payments as being successive supplies when the payments become due or are received, whichever is earlier.

Example

Jacob insures his car for a 12-month period with a non-resident insurance provider on 15 January 2016 and he elects to pay for the insurance in monthly instalments. The non-resident insurance provider is able to treat those monthly instalments as not being successively supplied under section 9(3) and, therefore, payments made after 1 October 2016 would not be subject to GST up until the 12-month contract ended.

Jacob has an accident and damages his car on 1 November 2016. He immediately makes a claim under his insurance contract. The insurance provider is unable to claim a deduction for any insurance payment made as it relates to a non-taxable supply of insurance.

RESIDENTIAL LAND WITHHOLDING TAX

Sections BE 1, BF 1, LA 6, LB 6B, RA 6C, RA 10, RA 15, RL 1–6, and YA 1 of the Income Tax Act 2007; sections 54B–54E, 81, and 139A of the Tax Administration Act 1994

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016 introduced a new withholding tax – residential land withholding tax (RLWT) – on sales of residential property made by "offshore RLWT persons" within two years of acquisition.

Background

Residential land withholding tax is primarily intended to support the "bright-line test" announced by the Government in Budget 2015 as part of a package of proposals to improve compliance with the residential investment property tax rules.

The bright-line test was enacted on 16 November 2015 in the Taxation (Bright-line Test for Residential Land) Act 2015. It requires income tax to be paid on any gains from the sale of residential property bought and sold within two years, with some exceptions – for example, if the property sold was the vendor's main home. It applies to land acquired on or after 1 October 2015.

Proposals for the RLWT were consulted on in an officials' issues paper, *Residential land withholding tax*, released in August 2015. It was originally proposed that RLWT apply when the vendor is an "offshore person", using the definition introduced in the Tax Administration Amendment Act 2015 and Land Transfer Amendment Act 2015 (referred to here as the "land information requirements"). Sixteen submissions were received. The issues paper also left open the question of whether the vendor's conveyancer or solicitor, or the purchaser's conveyancer or solicitor should be the withholding agent, and outlined the advantages and disadvantages of each approach.

Feedback from that consultation, including with the Auckland District Law Society, New Zealand Law Society, and New Zealand Society of Conveyancers, whose members are required to administer the withholding tax, helped to shape the RLWT measures in the new legislation.

A number of modifications were subsequently made to the original proposals, which were then introduced in the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill on 16 November 2015. The main modifications included:

- broadening the scope of "offshore person" in response to submissions that the definition used for land information requirements would be too difficult for RLWT agents to determine and verify;
- requiring the vendor's conveyancer or solicitor involved in the land disposal to be the RLWT withholding agent; and
- reducing the amount of RLWT payable, when payment would leave insufficient funds for a mortgage with a New Zealand-registered bank or non-bank deposit taker under the Non-bank Deposit Takers Act 2013 to be paid. This reduction is only available when the vendor's conveyancer or solicitor is the RLWT agent.

Further refinements to the proposals were recommended by the Finance and Expenditure Committee in response to submissions made at the select committee stage of the bill. The main recommendations included:

- renaming "offshore person" to "offshore RLWT person" to avoid confusion with the land information requirements;
- narrowing the definition of "offshore RLWT person" as it applies to companies and trusts, to make it more consistent with the approach taken in the Overseas Investment Act 2005;
- introducing an RLWT exemption certificate regime to relieve cashflow pressures in certain situations. Offshore RLWT persons in the business of developing land, erecting buildings, or dividing land into lots will be able to apply for an RLWT exemption certificate if they have complied with all of their tax obligations or are able to provide sufficient security to the Commissioner (for example, a bank bond). Offshore RLWT persons who would be eligible for the main home exclusion under the bright-line test will also be able to apply for an RLWT exemption certificate;
- reducing the amount of RLWT payable, where payment of RLWT would leave insufficient funds for the vendor's outstanding local authority rates to be paid;
- applying late filing penalties for RLWT agents to ensure the timely provision of information to Inland Revenue; and
- streamlining and simplifying the information provision requirements.

Key features

As the RLWT is primarily a collection mechanism for the bright-line test, the RLWT follows as closely as possible the concepts used in the bright-line test. However, there are some instances where the framework departs from that of the bright-line test to ensure that the RLWT is able to be administered by agents.

RLWT applies when:

- the property being sold is "residential land" located in New Zealand and defined for the purposes of the bright-line test as introduced in the Taxation (Bright-line Test for Residential Land) Act 2015;
- the vendor acquired the property on or after 1 October 2015 and has owned the property for less than two years before disposing of it (the two-year holding period used in the bright-line test); and
- the vendor is an "offshore RLWT person".

RLWT does not apply when the vendor holds a certificate of exemption.

Offshore RLWT persons

An "offshore RLWT person" includes all non-New Zealand citizens and individuals who do not hold residence class visas granted under the Immigration Act 2009. It also includes a New Zealand citizen who is living overseas, if they have not been physically present in New Zealand within the last three years. A holder of a New Zealand residence class visa may be an offshore person if they are outside New Zealand and have not been in New Zealand within the last 12 months.

New Zealand trusts and companies may also be "offshore RLWT persons" if there are significant offshore interests in them.

A New Zealand company is an offshore RLWT person, if more than 25 percent of the directors or holders of the shareholder decision-making rights are themselves offshore persons. This 25 percent threshold rule also applies for limited partnerships and look-through companies, which are legal entities.

Similarly, a trust is an offshore RLWT person if more than 25 percent of the trustees or persons with the power to appoint or remove trustees or amend the trust deed are themselves offshore persons.

However, the general 25 percent rule does not apply to beneficiaries. A trust is an offshore RLWT person if any one of the following applies:

- all of the natural person or non-natural person beneficiaries (discretionary and non-discretionary) are offshore;
- a non-natural person offshore beneficiary has received a distribution from the trust within the previous four years;
- a natural person offshore beneficiary has received distributions from the trust totalling more than $5,000 in any of the previous four years; or
- there is an offshore beneficiary and the trust has disposed of residential land within the previous four years.

These rules seek to ensure that a family trust where the beneficiaries are now living overseas or are on their OE will not be an "offshore RLWT person".

For transparent entities like partnerships and co-ownership situations, the offshore status of each partner or owner needs to be considered and RLWT will be calculated and allocated accordingly.

Further detail on what constitutes an "offshore RLWT person" can be found in the section titled "When RLWT applies", under the subsection "Offshore RLWT persons".

Exemptions from RLWT

No exemption for the vendor's main home is available for the purposes of the RLWT, unless the vendor has a valid RLWT exemption certificate from Inland Revenue and has provided this to the RLWT agent.

This is because RLWT only applies to offshore RLWT persons, so it is unlikely that the property being sold is an offshore RLWT person's main home. If it is the offshore RLWT person's main home, it would be difficult for the withholding agent to verify, so an exemption certificate regime is appropriate.

An RLWT exemption certificate is also available to persons in the business of developing land, erecting buildings or dividing land into lots. To obtain an exemption certificate, the developer, builder or subdivider must have either complied with all of their tax obligations or provided acceptable security to the Commissioner of Inland Revenue – for example, a bank bond.

Further detail on this can be found in the section titled "When RLWT applies".

Alternatively, if the vendor does not hold an exemption certificate and RLWT is withheld and paid to Inland Revenue, the vendor may file an "interim claim" to obtain a refund of the overpaid RLWT before the end of the income year.

The section titled "Interim claims" has further information on the interim claim process.

RLWT agent

The obligation to pay RLWT primarily lies with the vendor's conveyancer or solicitor, as agent for the vendor. A conveyancer or solicitor provides conveyancing services as defined in the Lawyers and Conveyancers Act 2006 and must have a New Zealand-based trust account.

If the vendor does not have a conveyancer or solicitor, the obligation to pay RLWT is on the purchaser's conveyancer or solicitor. In the absence of either, the obligation to pay RLWT is on the purchaser themselves. In these situations, the person with the obligation to pay RLWT is referred to as the "paying agent". If the vendor and purchaser are associated persons, the purchaser is liable for the payment of RLWT and is known as a "withholding agent".

The person who is required to pay or withhold RLWT is referred to as the "RLWT agent" in this explanatory report except when there are differences in the treatment between withholding agents and paying agents (for example, in relation to penalties and underlying liability). In these situations, this explanatory report distinguishes between paying agents and withholding agents.

RLWT is not a traditional withholding tax in the sense that paying agents are not held jointly and severally liable for the RLWT if they have not retained the RLWT from the settlement funds.

This is the correct outcome when the paying agent has not retained RLWT from the settlement amount before paying the funds to the vendor. This is because the RLWT paying agent would not be able to recoup the debt from the vendor if the paying agent were held liable for the underlying RLWT debt.

As this is a departure from "normal" withholding tax treatment, the Commissioner of Inland Revenue is able to report cases of RLWT non-compliance to the conveyancing agent's professional body – for example, the New Zealand Law Society or the New Zealand Society of Conveyancers – for appropriate action to be taken.

Note that when the vendor and purchaser are associated persons, the purchaser can be liable for the underlying amount of RLWT.

The RLWT agent must pay the required amount of RLWT to the Commissioner by the 20th of the following month, together with information relating to the transaction. However, they can also pay RLWT to the Commissioner on a transaction-by-transaction basis immediately following settlement, if desired.

The Commissioner of Inland Revenue can still apply the monetary penalties applicable to other withholding taxes (including both civil and criminal penalties) – for example, shortfall penalties, late payment penalties and late filing penalties.

Further detail on this can be found in the section titled "When RLWT obligations not met".

Calculating RLWT

There are three calculations required to determine the amount of RLWT payable. The amount of RLWT required to be withheld will be the lowest of the following three amounts:

- 33% (or 28% if the vendor is a company) × (current purchase price – vendor's acquisition cost);
- 10% × the current purchase price; and
- current purchase price – outstanding local authority rates – security discharge amount.

In general, RLWT must be paid before other disbursements are made at the time of settlement.

However, under the third calculation outlined above, an allowance has been made for the vendor's outstanding local authority rates in relation to the property. If the payment of the vendor's outstanding local authority rates would result in insufficient funds being available to pay RLWT, the amount of RLWT payable is reduced to the extent necessary to ensure that the outstanding local authority rates are able to be paid.

In addition, if the vendor's conveyancer is the RLWT agent, the amount of RLWT payable is reduced to the extent necessary to discharge the vendor's mortgage obligation with a New Zealand-registered bank or non-bank deposit taker licensed under the Non-bank Deposit Takers Act 2013.

Further detail on this can be found in the section titled "Calculating RLWT".

Credit for and repayment of RLWT

RLWT is not a final withholding tax. The vendor is able to claim a tax credit for the amount of RLWT withheld and paid to the Commissioner against their final income tax liability in relation to the sale of the residential property.

In some cases, this may result in a tax refund. The vendor does not need to wait until the end of the tax year to do this. As long as they have no outstanding tax obligations, the vendor can file an "interim claim", which includes all of the vendor's land-related income and costs for the year to date.

Application dates

The RLWT rules apply to a "residential land purchase amount" made on or after 1 July 2016, but only in relation to residential land acquired on or after 1 October 2015 and subsequently disposed of. If a vendor has entered into an agreement to dispose of the property before 1 July 2016, RLWT may still apply because settlement occurs on or after 1 July 2016.

Residential land acquired before 1 October 2015 is not subject to RLWT.

Detailed analysis

New tax type: Residential land withholding tax

The RLWT rules are set out in new subpart RL. RLWT applies to certain disposals of residential land.

New section RA 6C of the Income Tax Act 2007 provides that a person required to pay RLWT under new section RL 2 and a person required to withhold and pay RLWT under new section RL 3, must pay RLWT to the Commissioner of Inland Revenue by the due date. Section RL 5 provides that RLWT must be paid on a monthly basis and section RA 15(2) provides that the due date is the 20th of the following month.

RLWT is, in effect, a new type of withholding tax. However, it is only a true withholding tax if the vendor and purchaser are associated persons. This situation is specified in new sections BE 1(6) and RL 3. In this situation, the purchaser must withhold the RLWT calculated. The meaning of "associated person" is set out in sections YB 1–16 of the Income Tax Act 2007. In this case, the person required to withhold RLWT (the purchaser) is referred to as a withholding agent and may be liable for the underlying amount of RLWT.

Where the vendor and purchaser are not associated persons, the person required to pay RLWT on behalf of the vendor ("the paying agent") is permitted to retain the amount of RLWT from the purchase price, similar to a withholding tax, but RLWT is instead listed in section BF 1(d) (and in section YA 1 as an ancillary tax). The ability to retain an amount of RLWT from the purchase price is provided for in new section RL 2(8) and the vendor is treated as receiving both the amount paid to them directly and the amount paid to the Commissioner. This provides assurance to the person correctly retaining or withholding RLWT from a payment to the vendor and paying this RLWT to the Commissioner that the vendor cannot say that they did not "receive" the full payment.

This distinction between "paying agent" and "withholding agent" is necessary because, in general, paying agents are not liable for the underlying amount of RLWT. This is provided for in new section RL 2(5). One exception is when the paying agent has retained an amount of RLWT, but has not paid this to the Commissioner.

The section titled "Person required to pay RLWT (the paying agent and the withholding agent)" provides further discussion on this issue. The term "RLWT agent" is used throughout this explanatory report to mean both paying agents and withholding agents.

When the obligation arises

The obligation to retain or withhold and pay RLWT generally arises upon settlement when, in most cases, the bulk of the purchase price is paid by the purchaser to the vendor via a conveyancer or solicitor. At this point the RLWT paying or withholding agent (RLWT agent) should retain or withhold RLWT from the funds being paid. Further information about who the RLWT agent is can be found in the section titled "Person required to pay RLWT (the paying agent and the withholding agent)".

New section RL 1 provides that in general, the obligation to pay RLWT arises if there is a "residential land purchase amount" and the conditions for payment are satisfied. The section titled "When RLWT applies" discusses when RLWT applies.

The definition of "residential land purchase amount" inserted into section YA 1 means an amount paid or payable for the disposal of the residential land in question, but excludes deposits and part-payments as long as all deposits and part-payments total, in aggregate, less than 50 percent of the purchase price for the land. This rolling aggregate ensures that part-payments are not used to circumvent the application of the RLWT.

Example

Elizabeth is an offshore RLWT person. Elizabeth agrees to sell her house to Rebecca for $500,000. The contract requires Rebecca to pay a 10 percent deposit of $50,000, with the remaining $450,000 to be paid upon settlement. The $50,000 deposit is not a residential land purchase amount, but the $450,000 paid upon settlement is a residential land purchase amount. RLWT is calculated based on the purchase amount of $500,000.

The residential land purchase amount in itself is not income for tax purposes. It is an amount that is paid, which triggers a withholding or retention obligation. The residential land purchase amount forms part of the consideration for the disposal of residential land, which may be income for the vendor under another part of the Income Tax Act 2007.

The obligation to pay RLWT is not restricted to instances where consideration for the property is paid in cash. In-kind consideration may form part of the transaction and the situation will be monitored to ensure that RLWT obligations are not evaded or avoided through the use of non-cash consideration, as this could raise concerns under the general anti-avoidance rule in section BG 1 of the Income Tax Act 2007. As noted, a paying agent is not liable for the underlying amount of RLWT if they are unable to retain RLWT, but shortfall penalties may apply depending on the level of culpability of the paying agent. The section titled "When RLWT obligations not met" sets out the different types of penalties in further detail.

Due dates for RLWT to be paid to the Commissioner

Once the obligation for RLWT has arisen and the appropriate amount of RLWT has been withheld or retained from a residential land purchase amount, new section RL 5 and an amendment to section RA 15 provide that the standard due dates for interim and other tax payments made on a monthly basis apply. The due date is specified in section RA 15(2) as being the 20th day of the following month.

This provides for the "batching" of various RLWT amounts, which may be preferable for a RLWT agent who handles a number of RLWT transactions in a month. RLWT agents are also permitted to pay RLWT amounts to the Commissioner on a transaction-by-transaction basis before the stipulated due date.

The transaction-by-transaction approach may be preferred by RLWT agents who handle RLWT transactions only occasionally, and by vendors who want to square up the amount of RLWT paid with their income tax liability in relation to the disposal of the residential land fairly soon afterwards.

Example

Susanna is a conveyancer and retains RLWT from four transactions during the month of March. Susanna pays the retained RLWT amounts to the Commissioner on the stated due date, 20 April.

Example

Bill is a conveyancer who normally pays RLWT amounts to the Commissioner on the 20th of the following month. However, for a particular transaction, Bill agrees with his client to pay the RLWT amount to the Commissioner immediately.

Example

Scott is a solicitor who only occasionally handles RLWT transactions and prefers not to hold onto the retained funds. Scott retains RLWT from a residential land purchase amount on 1 August. He is not required to pay this amount to the Commissioner until 20 September, but chooses to pay the RLWT amount to the Commissioner the following week.

Tax credit for RLWT paid

Section LA 6 has been amended and section LB 6B inserted to provide that a person has a tax credit for a tax year equal to the amount of RLWT paid in relation to residential land they have disposed of. Section LB 6B provides that the RLWT tax credit arises in the income year in which they dispose of the relevant residential land because this is when income will be derived and this ensures that the RLWT tax credit can be credited against the person's income tax liability in the appropriate year.

The vendor is eligible for an RLWT credit for the amount retained or withheld by the RLWT agent. In some cases, this might not be the same as what is paid by the paying agent to the Commissioner. The Commissioner may need to investigate whether the full amount claimed was actually retained, in order to retain the integrity of the RLWT rules and to prevent fraudulent claims from being processed. Under existing law, the Commissioner is able to provide appropriate relief to the vendor, if satisfied that the paying agent has retained more than what was paid to the Commissioner and there is no underlying mischief. This addresses concerns surrounding the lack of visibility as to the true underlying relationship between the vendor and paying agent, combined with the fact that the paying agent is not automatically jointly and severally liable for the full RLWT debt.

Example

Bernard is an offshore RLWT person who has recently sold his house and has had $15,000 of RLWT retained from the settlement funds by his paying agent. Inland Revenue has received $10,000 that is allocated to Bernard's IRD number.

In his income tax return, Bernard declares in his tax return that his RLWT credit is $15,000.

Following further investigation, the Commissioner is satisfied that there is no mischief on Bernard's behalf and that the paying agent did retain $15,000. The Commissioner takes action against the paying agent and recovers the remaining $5,000 and provides Bernard the full RLWT credit of $15,000.

It is expected that a credit under section LB 6B will be used primarily to offset the person's income tax liability from the disposal of residential property.

Section LA 6 provides that the RLWT credit can be used to satisfy the person's other income tax liabilities, to the extent that the amount of RLWT paid exceeds their income tax liability, in relation to the disposal of the residential property.

The excess RLWT may be refunded if the person has no other income tax liabilities.

Example

Patrick is an offshore RLWT person who sold his residential property, and $40,000 of RLWT was withheld from the settlement amount. Patrick's income tax liability in relation to the disposal is only $35,000. Patrick has no other tax liabilities. Inland Revenue issues a refund to Patrick of $5,000.

A person can lodge an interim claim before the end of an income year, returning their taxable income arising from land, to obtain a refund of excess RLWT. However, as this is merely an interim claim, it is not considered to be final, and the person will still need to lodge an income tax return at the end of the income year. RLWT generally needs to be received by the Commissioner before a refund is issued as part of an interim claim, to prevent fraudulent claims from arising.

Interim claims are provided for in new section RL 6 of the Income Tax Act 2007, and new section 54D of the Tax Administration Act 1994. Further detail on interim claims can be found in the section titled "Interim claims".

RLWT must be paid before other disbursements

RLWT must be paid before other disbursements, such as mortgages, are made as part of the settlement process. This is so RLWT cannot be circumvented by gearing up before disposal of the residential property or making a number of disbursements at the time of settlement, when RLWT must also be paid.

Normally this is not a problem because withholding taxes are generally paid by the payer of an amount at the first possible opportunity. For example, in other jurisdictions with an equivalent regime to RLWT, the withholding tax must be paid by the purchaser before the settlement funds are passed to the vendor or the vendor's agent. This means the withholding tax is paid before any other disbursements are made.

Sometimes, the payment of RLWT before other disbursements may leave insufficient funds for the vendor's mortgage obligation to be discharged.

New section RL 4(6) provides that in limited circumstances, the amount of RLWT payable is reduced to the extent required to discharge a mortgage obligation held with a New Zealand-registered bank or non-bank deposit taker licensed under the Non-bank Deposit Takers Act 2013. However, this is restricted to instances where the vendor's conveyancer or solicitor is the RLWT agent. If the RLWT agent is the purchaser's conveyancer or solicitor, or is the purchaser themselves, this reduction for a New Zealand mortgage is not available.

Section RL 4(6) also provides that when necessary, the amount of RLWT is reduced to take account of the vendor's outstanding local authority rates at the time of the disposal.

Further information can be found in the sections titled "Calculating RLWT" and "Person required to pay RLWT (the paying agent and the withholding agent)".

If there are other charges that are being cleared as part of the settlement process, for example, unpaid body corporate levies or a loan held with a party that is not a licensed security holder, the paying agent has a number of possible courses of action if there are insufficient funds for RLWT to be paid – for example, they may require the vendor to pay the additional funds to ensure those payments can be made. While a paying agent is not liable for the underlying amount they did not withhold, they may be subject to shortfall penalties depending on their level of culpability. For further information on civil and criminal penalties, refer to the section titled "When RLWT obligations not met".

Officials will continue to monitor the situation to ensure that this provision is not used to undermine the integrity of the new RLWT rules and the broader tax system.

Non-fulfilment of RLWT obligations

This is discussed in the section titled "When RLWT obligations not met", but generally the standard penalties that apply to other withholding taxes apply in the context of RLWT, including late filing penalties. In addition, an amendment has been made to section 81 of the Tax Administration Act 1994 to allow the Commissioner to report repeated or deliberate instances of non-compliance to an RLWT agent's professional body.

When RLWT applies

RLWT applies to disposals of residential land, where a "residential land purchase amount" is paid or payable on or after 1 July 2016. In most standard cases, the payment of a residential land purchase amount occurs upon settlement where the bulk of the purchase price is paid by the purchaser. A discussion on the meaning of "residential land purchase amount" can be found in the section titled "New tax type: Residential land withholding tax".

RLWT applies to a disposal when all three following conditions are met:

- the land being disposed of must be residential land located in New Zealand;

- the vendor is within the two-year period for the bright-line period for the land, where the vendor originally acquires the land on or after 1 October 2015; and
- the vendor is an offshore RLWT person.

RLWT does not apply to residential land acquired before 1 October 2015.

Residential land in New Zealand

New section RL 1(2) provides that RLWT only applies to residential land located in New Zealand. This restriction is necessary, otherwise RLWT could apply to disposals of property situated overseas where the transaction has no link to New Zealand.

The meaning of "residential land" follows the definition used for the bright-line test, and is:

- land that has a dwelling on it;
- land for which the owner has an arrangement that relates to erecting a dwelling;
- bare land that may be used for erecting a dwelling under the rules in the relevant operative district plan;
- but does not include land that is farmland or used predominantly as business premises.

Further information on the meaning of "residential land", including examples, is available in Inland Revenue's February 2016 *Tax Information Bulletin* on the bright-line test legislation (Vol 28, No 1).

Within two-year bright-line period

New section RL 1(2)(a) provides that, in addition to being residential land located in New Zealand, the vendor must be within the two-year bright-line period for the property being disposed of.

More specifically, new section RL 1(2)(a) requires the residential land purchase amount from the disposal to be income of the vendor under section CB 6A, or it would be income of the vendor but for the main home exclusion in section CB 16A or the application of another land taxing provision in section CB 6A(6).

This means that the land needs to be acquired on or after 1 October 2015 and the person's bright-line date for that land is within two years of acquisition. Land acquired before 1 October 2015 is not subject to the bright-line test or RLWT.

Further information on how to calculate the two-year bright-line period is provided in the *Tax Information Bulletin* item on the bright-line test legislation (Vol 28, No 1), but in most cases the bright-line period begins on the date the person's title to the residential land is registered under the Land Transfer Act 1952, and ends on the date that the person enters into the agreement for the disposal of the residential land. If the end date (or "bright-line date") is within two years of the start date, the requirement in section RL 1(2)(a) is met.

A summary of the start and end dates to calculate the bright-line period for most types of property transactions is shown below:

Start date	End date ("bright-line date")
• the date on which the instrument to transfer the land to the person was registered under the Land Transfer Act 1952 • the date of entry into a contract to purchase, for sales "off the plan" • the date of acquisition of the land according to ordinary rules, if an instrument to transfer the land to the person is not registered on or before the bright-line date.	• the date that the person enters into an agreement for the disposal • the date on which the person makes a gift of the residential land • the date on which the person's residential land is compulsorily acquired under any Act by the Crown, a local authority, or a public authority • if there is a mortgage secured on the residential land, the date on which the land is disposed of by or for the mortgagee as a result of the mortgagor's defaulting • or if none of the above apply, the date on which the estate or interest in the residential land is disposed of.

If the residential land being disposed of was subdivided, the start date is when the title to the undivided land was registered. Further detail on subdivisions and other types of property transactions can be found in the T*ax Information Bulletin* item for the bright-line test (Vol 28, No 1).

The vendor is required to provide information under section 54C of the Tax Administration Act 1994 to the RLWT agent detailing whether the disposal is subject to RLWT. Further detail on what the vendor is required to provide can be found in the section titled "Information requirements". To confirm that the information provided by the vendor is correct, the RLWT agent can obtain the title registration date from Land Information New Zealand's Landonline system, which is available to conveyancers and solicitors. In most circumstances, the RLWT agent should be able to obtain the "bright-line date" from the agreement for sale and purchase for the vendor's disposal.

In a standard scenario when a prospective purchaser makes an offer on a house, but the offer is conditional on the purchaser obtaining satisfactory financing and/or a builder's report, the vendor's bright-line date is the date on which they accept the purchaser's conditional offer, not when the agreement goes unconditional. If the terms of the agreement are amended as a result of these conditions, the end of the bright-line period is still the date on which the vendor entered into the agreement to dispose of the property.

Example

Florence is selling her house. Ash is a prospective buyer and makes an offer on Florence's house on 18 April. The agreement is conditional on Ash obtaining financing within five working days of Florence's acceptance of Ash's offer. Florence accepts Ash's conditional offer and signs the agreement on 19 April. Ash obtains suitable financing on 22 April and the agreement goes unconditional that day. Florence's bright-line date is 19 April because this is the date that Florence enters into the agreement to dispose of the house.

If the vendor's bright-line date for the residential land is within two years, but the vendor is not taxed under section CB 6A because another land taxing provision applies, RLWT still applies. This is because the vendor has an income tax liability in relation to the disposal and the purpose of the RLWT is to act as a collection mechanism for income tax. The vendor should not be able to avoid RLWT merely because another taxing provision applies to the transaction.

There are implicit exemptions from RLWT or rollover relief for inherited property and for transfers of relationship property, which are provided for in the bright-line test. This is achieved through section RL 1(2)(a) which refers to an amount that is income, or would be income but for the main home exclusion or another land taxing provision.

During a marriage, civil union or de facto relationship, the parties hold any property according to the conventional laws relating to property. As a result, the parties are free to deal with their property during the relationship without regard to the provisions of the Property (Relationships) Act 1976. When a relationship breaks down, the Property (Relationships) Act 1976 may be invoked by a court order or an agreement between the parties. When this statutory regime is invoked, new property rights operate from the date of the court order or agreement. The property of the spouses or partners is reapportioned between them under principles from this statutory regime.

Rollover relief generally means that when part or all of a specific property is transferred from one party to another under a relationship property agreement, the transferee takes on the cost base of the transferor – that is, they are treated as having acquired their recently acquired portion at the same time for the same cost as when the transferor originally acquired the property. Through section FB 3A, this means there should be no RLWT to pay in relation to the transfer from one party to the relationship property agreement to the other. This is because the transfer is treated as a disposal and acquisition for an amount that equals the total cost of the residential land to the transferor at the date of transfer. However, depending on the circumstances, there may be a requirement to account for RLWT, even though the amount of RLWT calculated is nil.

If the transferee subsequently disposes of the residential land within two years from when the transferor originally acquired it, that sale is within the scope of the bright-line test and RLWT.

Offshore RLWT persons

New section RL 1(2) sets out the criteria for the RLWT rules to apply. In addition to the land being New Zealand residential land and being disposed of within the two-year bright-line period, the vendor must be an "offshore RLWT person" for RLWT to apply. "Offshore RLWT person" is defined in section YA 1 and covers both individuals and non-individuals, such as companies or trusts.

The vendor must provide a statement under section 54C of the Tax Administration Act 1994 that they are/are not an offshore RLWT person in a form prescribed by the Commissioner of Inland Revenue. At the time of writing, the IR1101 is the form required to be filled in by the vendor under section 54C. The person who fills in the form will be subject to criminal penalties if they knowingly provide false information, as it is information provided in relation to a tax law. Certain accompanying documents are also required.

New section RL 2(7) provides that a paying agent is able to "reasonably rely" on the information in the completed IR1101 form and the accompanying documents provided under section 54C. This "reasonable reliance" test enables paying agents to rely on the information provided to them by vendors, unless they know the information to be false or they suspect it to be false (for example, if the passport appears to be fraudulent). This reasonable reliance test does not extend to RLWT agents who are withholding agents under section RL 3.

Section 54C of the Tax Administration Act 1994 requires that the vendor must provide this information to the RLWT agent before a residential land purchase amount is made. If the IR1101 form has not been provided by the vendor, the RLWT agent may assume the vendor is an offshore RLWT person and therefore withhold RLWT if the other requirements for withholding have been met (New Zealand residential land being disposed of within the two-year bright-line period). An exception to this would be when the

RLWT agent has reasonable grounds for establishing that the vendor is not an offshore RLWT person – for example, a long-standing client relationship such that the RLWT agent knows the vendor not to be an offshore RLWT person.

Further information on the information that must be provided as part of the section 54C requirements and what constitutes "reasonable reliance" can be found in the section titled "Information requirements".

Natural persons

Subsection (a) of the definition of "offshore RLWT person" in section YA 1 sets out when a natural person is an offshore RLWT person. It is the same as the definition of "offshore person" in the Tax Administration Act 1994 as introduced by the Tax Administration Amendment Act 2015 and the Land Transfer Amendment Act 2015 for the land information requirements. The definition is used to determine who must have a New Zealand bank account (or have had customer due diligence identity verification carried out by a reporting entity) when applying for an IRD number, and who must provide their IRD number when buying or selling residential property.

An individual is an offshore RLWT person if they are not a New Zealand citizen and do not hold a New Zealand residence class visa as defined in the Immigration Act 2009. A residence class visa is a resident visa or a permanent resident visa. Student visas and work visas, for example, are not residence class visas.

Example

Mary is an investor in residential property. She sells a piece of residential land located in Auckland to Jim. Mary is in New Zealand at the time of the sale, but she is not a New Zealand citizen and does not hold a residence class visa granted under the Immigration Act 2009. Mary is an "offshore RLWT person".

A New Zealand citizen is nevertheless an offshore RLWT person if they are outside New Zealand and have not been in New Zealand within the last three years. A single day (or part-day) of presence in New Zealand during the past three years is enough for a New Zealand citizen not to be an offshore RLWT person.

A holder of a New Zealand residence class visa is an offshore RLWT person if they are outside New Zealand and have not been in New Zealand within the last 12 months. Again, a single or part-day of presence in New Zealand within the past 12 months is enough to satisfy the physical presence test.

Example

Tane is a New Zealand citizen and is relocated overseas with his job. Eighteen months after moving overseas, he sells his residential property. Tane has not been back in New Zealand since relocating. Tane is not an offshore RLWT person at the time of the sale.

Generally, Australian citizens and permanent residents are granted a resident visa on arrival in New Zealand under the Immigration Act 2009 and subsequent regulations, but this visa expires when the individual leaves New Zealand. If they subsequently re-enter New Zealand, they are issued a new resident visa. This means that if an Australian citizen or an Australian permanent resident is physically present in New Zealand at the time of the sale, they are not an offshore RLWT person. However, they may be an offshore RLWT person if they are outside New Zealand at the time of the sale and have not applied for a New Zealand permanent resident visa or New Zealand citizenship.

In most cases it is likely that the reasonable reliance test can be satisfied when a New Zealand citizen or holder of a residence class visa who is selling their property within two years meets with the paying agent in person and shows them their passport. The conveyancing agent should take a copy of the documentation and record that they have seen the person in New Zealand. As the vendor is currently in New Zealand, this means they are not an offshore RLWT person.

If an individual is selling their property from outside New Zealand, they are required to provide suitable proof to the RLWT agent that they are not an offshore RLWT person. This could include a certified statement and copy of their New Zealand passport or residence class visa, as well as evidence of flights to New Zealand within the relevant timeframe. This enables the paying agent to "reasonably rely" on their statement that they are not an offshore RLWT person.

Partnerships and other joint or co-ownership situations

For partnerships and other cases where the vendors hold the property jointly (for example, as tenants in common or as part of a joint tenancy) the offshore status of each partner or co-owner is considered individually and then RLWT applies to the offshore RLWT person's share in the property. This is provided for in section RL 1(3). In this case, each partner or co-owner is required to provide information in a separate IR1101 form under section 54C of the Tax Administration Act 1994.

In the case of a partnership, RLWT applies according to the income interests held by offshore RLWT persons. To enable the RLWT agent to do this, the partners must provide the RLWT agent with a copy of the partnership agreement or a statement regarding their income interests in the partnership. Knowingly providing incorrect information is a criminal offence.

For other co-ownership situations, the RLWT agent can assume that the property is equally divided between co-owners, unless evidence to the contrary is provided.

This is a different approach to that proposed in the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill at the time of introduction. It was then proposed that an offshore partner or co-owner would taint the transaction, and RLWT would subsequently apply to the whole transaction.

Example

Rebecca is a New Zealand citizen and Sebastian is a holder of a residence class visa. They are both physically present in New Zealand when they purchase a New Zealand residential property and hold the property as joint tenants. For the purposes of RLWT, their respective shares are 50 percent each, even though as joint tenants they have the equal, undivided shares in the property. Rebecca and Sebastian go travelling immediately after purchasing the property. After 15 months, they decide to sell the property and neither of them has been back in New Zealand since they purchased the property. Sebastian is an offshore RLWT person, but Rebecca is not. The property is sold for $500,000, so Sebastian's share is $250,000. The RLWT agent calculates RLWT in relation to Sebastian's $250,000 share and, in returning the retained RLWT to the Commissioner of Inland Revenue, allocates it to Sebastian's IRD number.

Companies and limited partnerships

This allocation rule does not apply for limited partnerships or look-through companies for example, which are corporate entities. Part (c) of the definition of "offshore RLWT persons" deals with legally corporate entities and covers both limited partnerships and look-through companies.

A non-natural person is an offshore RLWT person if any of the following conditions are met:

- it is incorporated outside New Zealand;
- it is registered outside New Zealand;
- it is constituted under foreign law;
- it is a company and more than 25 percent of the company's directors are offshore RLWT persons or more than 25 percent of the shareholder decision-making rights are held directly or indirectly by offshore RLWT persons;
- it is a partner in a limited partnership and more than 25 percent of the general partners are offshore RLWT persons or more than 25 percent of the partnership's shares are held directly or indirectly by offshore RLWT persons; or
- it is an owner of an effective look-through interest in a look-through company and more than 25 percent of the look-through company's effective look-through interests are held directly or indirectly by offshore RLWT persons.

A company (including a unit trust) is not an offshore RLWT person when all of the following conditions are met:

- the company is incorporated in New Zealand and not registered overseas; and
- no more than 25 percent of the directors of the company are offshore RLWT persons; and
- no more than 25 percent of the shareholder decision-making rights of the company are held by offshore RLWT persons.

A limited partnership is not an offshore RLWT person when all of the following conditions are met:

- the limited partnership is incorporated in New Zealand and not registered overseas; and
- no more than 25 percent of the general partners are offshore RLWT persons; and
- no more than 25 percent of the shares (voting interest or income interest) in the partnership are held directly or indirectly by offshore RLWT persons.

Trusts

Subsection (b) of the definition of "offshore RLWT person" in section YA 1 sets out when a trustee of a trust is an offshore RLWT person.

A person that is a trustee of a trust is an offshore RLWT person for the purposes of the RLWT rules if any of the following conditions are met:

- more than 25 percent of the trustees of the trust are offshore RLWT persons;
- more than 25 percent of the people that have the power to appoint or remove a trustee of a trust, or to amend the trust deed, are offshore RLWT persons;
- all natural person beneficiaries (including discretionary beneficiaries) of the trust are offshore RLWT persons;
- all beneficiaries (including discretionary beneficiaries) of the trust are offshore RLWT persons;

- a beneficiary (including a discretionary beneficiary) that is not a natural person and is an offshore RLWT person has received a distribution from the trust within the last four years of a relevant disposal of residential land;
- a natural person beneficiary (including a discretionary beneficiary) that is an offshore RLWT person has received distributions from the trust of more than $5,000 in any one year of the past four years prior to the relevant disposal of residential land; and
- a beneficiary or discretionary beneficiary of the trust is an offshore RLWT person and the trust has disposed of residential land within four years before the current disposal.

A 25 percent control test applies to trustees and persons with the power to appoint/remove trustees or amend the trust deed (set out in subsection (b)(i) and (ii) of the definition of offshore RLWT person). If the 25 percent threshold has not been breached, the trust may nevertheless be an offshore RLWT person depending on the status of the beneficiaries.

Generally, it is expected that the settlors of a trust would have the power to appoint/remove trustees or amend the trust deed. Looking at the offshore status of people with this power prevents the situation where a trust, with an offshore settlor and resident trustees, sell the property (without being subject to a withholding tax), with the settlor then replacing resident trustees with trustees who are offshore persons and beyond the reach of Inland Revenue. This requirement is consistent with the settlor focus for trusts in New Zealand's income tax rules.

In addition, the trustees of a discretionary trust have the ability to shift the tax liability to one of the beneficiaries by distributing the income to the beneficiary and treating it as beneficiary income. To ensure that the gain does not escape tax by being transferred to an offshore beneficiary, a trust can be an offshore RLWT person if a beneficiary is an offshore RLWT person and they have received certain distributions.

Note that there is no percentage test in relation to beneficiaries, even though there is a 25 percent control test in relation to trustees and settlors.

The first limbs of the test for beneficiaries (subsections (b)(iii) and (iv)) are relatively narrow in that all natural person beneficiaries (including discretionary beneficiaries) or all beneficiaries of the trust must themselves be offshore RLWT persons. The intention was that trusts that own the family home should not be an offshore RLWT person solely because some of the beneficiaries were offshore (for example, adult children working overseas), but it should not be possible to set up a trust in which all beneficiaries are foreign investors who are natural persons, with a New Zealand charity appointed as a discretionary beneficiary simply to avoid being classed as an offshore RLWT person.

Example

Matilda and Madeline are natural persons who are also offshore RLWT persons. They are the only natural person beneficiaries of a trust. A New Zealand charity is appointed as a discretionary beneficiary of the trust. The settlor and trustees of the trust are not offshore RLWT persons. The trustees are treated as offshore RLWT persons for the purposes of the RLWT rules, because all natural person beneficiaries of the trust (Matilda and Madeline) are offshore RLWT persons.

The remaining limbs of the test for beneficiaries (subsections (b)(v) and (vi)) address concerns about possible misuse of trusts in order to evade payment of RLWT, and therefore deal with distributions made to beneficiaries who are offshore RLWT persons, and situations when the trust has already recently disposed of residential land.

A trust is **not** an offshore RLWT person if a natural person beneficiary (discretionary or otherwise) who is an offshore RLWT person receives $5,000 or less in distributions from the trust in each of the four years before the current disposal of residential land. However, the trust is an offshore RLWT person if that beneficiary has received more than $5,000 of distributions from the trust in any of the four years before the current disposal of residential land.

There is no minimum threshold in the case of non-natural person beneficiaries, so that if a non-natural person beneficiary (discretionary or otherwise) who is an offshore RLWT person has received any distributions from the trust during the four years before the current disposal of residential land, the trust would constitute an offshore RLWT person.

This means that a small annual distribution of dividends paid to a beneficiary of a family trust, for example, does not result in the trust becoming an offshore RLWT person, but a distribution to a beneficiary that is a company and an offshore RLWT person does.

Example

Debbie and Greg are the settlors and trustees of a family trust. They are both New Zealand citizens and live in New Zealand. Dan and Natalie are discretionary beneficiaries of the trust and are also New Zealand citizens. Dan lives in New Zealand, but Natalie has lived in Australia for the past five years and has not been back to New Zealand.

The trust property consists of the family home in New Zealand as well as some shares and money held in a savings account. Each year, Dan and Natalie receive around $1,000 each in distributions from the trust.

Debbie and Greg as trustees of the trust are not offshore RLWT persons, because they themselves are not offshore RLWT persons and, of the two beneficiaries, only Natalie is an offshore RLWT person, but she has not received more than $5,000 in distributions from the trust in any of the previous four years.

It is not necessary to determine whether the offshore beneficiary (discretionary or otherwise) was an offshore RLWT person at the time of each distribution. The test looks at whether a beneficiary or discretionary beneficiary who is currently an offshore RLWT person has received a distribution from the trust within the past four years of the relevant disposal of residential land. In the case of natural persons, the test looks at whether a natural person beneficiary or natural person discretionary beneficiary who is currently an offshore RLWT person has received $5,000 or more from the trust in any one year during the past four years.

A trust is also an offshore RLWT person, if any of the beneficiaries (discretionary or otherwise) are offshore RLWT persons and the trust has disposed of residential land within four years of the current disposal. While the offshore RLWT person definition should not capture family trusts where a beneficiary is an offshore RLWT person and the family's main home is being sold, if the trust has a history of buying and selling residential land and there is an offshore beneficiary, the trust is classified as an offshore RLWT person for integrity reasons.

Corporate trustees must satisfy both the trust and company criteria if they are not to be considered an offshore RLWT person.

It is important to note that the non-natural person component of the definition of offshore RLWT person differs from the definition of "offshore person" introduced in the land information requirements. The definition of offshore person as it relates to non-natural persons follows that used for "overseas person" in section 7(2)(b) to (f) of the Overseas Investment Act 2005. The main differences between the RLWT definition and the land information requirement definition for companies, limited partnerships, partnerships and trusts are outlined in the following table.

"Offshore RLWT person" – RLWT purposes	"Offshore person" – land information requirements

• It is a body corporate (such as a company) and:
• it is incorporated outside New Zealand;
• it is registered outside New Zealand or constituted under foreign law;
• it is a company and:
  – more than 25 percent of the company's directors are offshore RLWT persons; or
  – more than 25 percent of the shareholder decision-making rights are held directly or indirectly by offshore RLWT persons
• it is a partner in a limited partnership and:
  – more than 25 percent of the general partners are offshore RLWT persons; or
  – more than 25 percent of the partnership's shares are held directly or indirectly by offshore RLWT persons; or
• it is an owner of an effective look-through interest in a look-through company and more than 25 percent of the look-through company's effective look-through interests are held directly or indirectly by offshore RLWT persons.
	It is a body corporate (such as a company) and:
	• it is incorporated outside New Zealand; or
	• 25 percent or more of its shares are owned by a body corporate incorporated outside New Zealand; or
	• an offshore person has (or offshore persons have):
	  – 25 percent or more of any class of securities;
	  – the power to control the composition of 25 percent or more of its governing body; or
	  – the right to exercise or control 25 percent or more of the voting power.

NEW LEGISLATION

The offshore status of each partner is considered individually and RLWT calculated according to the income interests held by offshore RLWT persons.	It is a partnership or other unincorporated body of persons (other than a trust) and: • 25 percent or more of its partners or members are offshore persons; or • an offshore person has (or offshore persons have) a beneficial interest in or entitlement to 25 percent or more of the profits or assets (including on winding up); or • an offshore person has (or offshore persons have) the right to exercise or control the exercise of 25 percent or more of the voting power at a meeting.
A person that is a trustee of a trust, if: • more than 25 percent of the trustees of the trust are offshore RLWT persons; or • more than 25 percent of the people that have the power to appoint or remove a trustee of a trust, or to amend the trust deed, are offshore RLWT persons; or • all natural person beneficiaries (including discretionary beneficiaries) of the trust are offshore RLWT persons; or • all beneficiaries (including discretionary beneficiaries) of the trust are offshore RLWT persons; or • a beneficiary (including a discretionary beneficiary) that is not a natural person and is an offshore RLWT person has received a distribution from the trust within the last four years of a relevant disposal of residential land; or • a natural person beneficiary (including a discretionary beneficiary) that is an offshore RLWT person has received distributions from the trust of more than $5,000 in any one year of the past four years prior to the relevant disposal of residential land; or • a beneficiary or discretionary beneficiary of the trust is an offshore RLWT person and the trust has disposed of residential land within four years before the current disposal.	It is a trust and an offshore person (or offshore persons): • constitute 25 percent or more of its governing body; or • has or have a beneficial interest in or entitlement to 25 percent or more of the trust property; or • are 25 percent or more of those that have the right to amend or control the amendment of the trust deed; or • are 25 percent or more of those having the right to control the composition of the trust's governing body.

Exemption certificates

Section RL 1(4) provides that the RLWT rules in subpart RL do not apply if the vendor holds an RLWT exemption certificate that applies for the disposal of the relevant residential land.

Certificates of exemption for RLWT purposes can be issued if certain requirements are met, in the following circumstances:

- the person is disposing of their main home; or
- the person disposing of the residential land is in the business of developing land, dividing land into lots or erecting buildings.

The introduction of this exemption certificate facility was in response to submissions made to the Finance and Expenditure Committee, and is available for offshore RLWT persons selling their main home, or offshore RLWT persons who are in the business of developing land, dividing land into lots or erecting buildings. The interim claim process was originally designed in lieu of a certificate of exemption facility to mitigate cashflow problems for people whose tax liability is likely to be lower than the amount of RLWT withheld. As a certificate of exemption needs to be issued before the sale of property and this involves an assessment by Inland Revenue of whether the person satisfies the criteria for a certificate of exemption, there may be potential for some sales to be delayed if the vendor needs to wait for the certificate to be issued. It was for this reason that the interim claim process was initially considered, overall, to be more appropriate. However, the issue of housing supply is an important one, and it was considered that RLWT should not further inhibit housing development, but the certificate of exemption should only be provided in bona fide cases when it was the vendor's main home or when the taxpayer is increasing housing supply, not simply renovating or speculating.

It was not considered appropriate to directly provide for the main home exclusion under the bright-line test (in section CB 16A) in the RLWT rules because whether the residential land was the vendor's main home may not be readily ascertainable by the RLWT agent. In addition, it is unlikely that the property being disposed of was the vendor's main home, as RLWT only applies to offshore RLWT persons.

Section 54E of the Tax Administration Act 1994 sets out the circumstances in which the Commissioner may issue RLWT exemption certificates. If the Commissioner is satisfied that the taxpayer is eligible for a certificate of exemption, then section 54E(5) provides that one must be issued.

Section 54E(1) requires the taxpayer to apply for a certificate of exemption using the form prescribed by the Commissioner and to provide certified copies of relevant and appropriate documents as prescribed by the Commissioner. At the time of writing, the RLWT exemption certificate application form is the IR1103.

The interim claim process is available for taxpayers who do not meet the requirements for, or have not been issued with, an RLWT exemption certificate. For further information on the interim claim process, see the section titled "Interim claims".

For a vendor disposing of their main home section 54E(4) provides that they must meet the requirements of section CB 16A of the Income Tax Act 2007, which provides the main home exclusion from the bright-line test. Whether the residential land was the vendor's main home for the period during which the vendor owned the property depends on the facts and circumstances, and appropriate evidence must be provided to the Commissioner so that she can make that determination. Further information about the main home exclusion in the bright-line test can be found in the *Tax Information Bulletin* on the bright-line legislation (Vol 28, No 1). An exemption certificate issued under section 54E(4) is only issued in relation to a particular disposal, rather than on an enduring basis.

Section 54E(2) and (3) provide that persons in the business of developing land, dividing land into lots or erecting buildings may apply for an RLWT exemption certificate. Evidence that they are in the business of one of these activities is required, and the nature of such evidence will be set out in further operational guidance. The terms "developing land", "dividing land into lots", and "erecting buildings" are already used in the Income Tax Act 2007 and have established meanings. It is important that RLWT exemption certificates are issued only to those who are increasing housing supply, not simply renovating or speculating.

Persons in the business of developing land, dividing land into lots or erecting buildings must also meet one of two additional criteria – they must have had tax obligations in New Zealand and have complied with all of them for the two years before they apply for an RLWT exemption certificate or they must provide a security that is acceptable to the Commissioner.

Section 54E(3)(b) and (c) provides that the person applying for the RLWT exemption certificate in relation to residential land must have had tax obligations under the Inland Revenue Acts before applying for the exemption certificate, and must have complied with **all** tax obligations for the two-year period before they apply for the certificate. The term "Inland Revenue Acts" encompass a number of different Acts and these are listed in the Schedule of the Tax Administration Act 1994. At the time of writing they are:

- Child Support Act 1991
- Estate and Gift Duties Act 1968
- Estate Duty Abolition Act 1993
- Estate Duty Repeal Act 1999
- Gaming Duties Act 1971
- Goods and Services Tax Act 1985
- Income Tax Act 1994
- Income Tax Act 2004
- Income Tax Act 2007
- KiwiSaver Act 2006
- Land Tax Abolition Act 1990
- Stamp and Cheque Duties Act 1971
- Stamp Duty Abolition Act 1999
- Student Loan Scheme Act 1992
- Student Loan Scheme Act 2011
- Tax Administration Act 1994
- Taxation Review Authorities Act 1994.

In addition, the Commissioner must be satisfied that the person will continue to comply with their tax obligations.

This provision is intended to cover established developers in the New Zealand housing market who have good tax compliance histories but happen to be offshore RLWT persons.

When a person disposing of residential land has not complied with all tax obligations under the Inland Revenue Acts over the previous two years, or has not been operating in New Zealand long enough to have the requisite compliance history, they can still apply for an RLWT exemption certificate if they provide security to the Commissioner to secure their income tax obligations in relation to the residential land. The intention is to avoid creating a barrier to entry for new developers in the New Zealand housing market, while also protecting the integrity of the tax system.

Section 54E(2)(b) provides that the security must be provided in accordance with section 7A of the Tax Administration Act 1994 and must be acceptable to the Commissioner to secure the performance of their income tax obligations in relation to the residential land. It was envisaged that bank bonds would be the most common type of security, but further operational guidance will be provided by Inland Revenue in relation to the type of securities that are acceptable for an RLWT exemption certificate.

While the wording in section 54E relates to a specific piece of residential land, it is envisaged that a person could include a schedule of different pieces of residential land that they intend to dispose of when they prepare their application under section 54E. This means the certificate of exemption will apply to multiple residential land titles.

Example

Alistair is an offshore RLWT person who has been in the business of developing residential land in New Zealand for ten years. Alistair has complied with all of his tax obligations under the Inland Revenue Acts since he started developing land in New Zealand, including the past two years.

Alistair acquired a piece of residential land which he has subdivided into ten lots, and is in the process of developing. Alistair thinks that he will be ready to sell the ten properties within the two-year bright-line period, so prepares his application for an RLWT exemption certificate. He includes a schedule listing all ten properties to be sold as part of his application and appropriate evidence that he is in the business of developing residential land.

The Commissioner is satisfied that Alistair is in the business of developing land, has complied with his tax obligations over the past two years, and will continue to comply in the future. Alistair is granted an RLWT exemption certificate in respect of all ten properties.

Note that when a vendor has an exemption certificate for RLWT purposes and the vendor is within the two-year bright-line period, they are still required to provide information to the RLWT agent under section 54C of the Tax Administration Act 1994. This is because section 54C stands alone from the RLWT rules in subpart RL of the Income Tax Act 2007. Further detail on the requirements under section 54C can be found in the section titled "Information requirements".

Person required to pay RLWT (the RLWT agent)

As noted in the section titled "New tax type: Residential land withholding tax", RLWT is generally not a true withholding tax in the sense that in most cases, the person required to pay RLWT is not liable for the underlying amount of RLWT if they did not retain the RLWT from the residential land purchase amount. Section RL 2 introduces the concept of "a paying agent" to account for this situation.

Section RL 3 provides that when the vendor and purchaser are associated persons, RLWT is a true withholding tax and the "withholding agent" is the purchaser.

What it means to be a paying agent or withholding agent is discussed in the section titled "New tax type: residential land withholding tax" and when the treatment between the two does not differ, the term "RLWT agent" is used.

Under section RL 2, the vendor is liable to pay an amount of RLWT, but the vendor's conveyancer is treated as the vendor's agent in relation to RLWT and must provide returns and satisfy the vendor's liability. That is, the vendor's conveyancer is the "paying agent" for RLWT purposes.

"Conveyancer" is a defined term in section YA 1 for the purposes of the RLWT rules. It refers to the lawyer, incorporated law firm, conveyancing practitioner or incorporated conveyancing firm that provides conveyancing services (as that term is used in the Lawyers and Conveyancers Act 2006) to the vendor or purchaser using a New Zealand-based trust account.

It is intended that only those who are able to describe themselves in New Zealand as lawyers, incorporated law firms, conveyancing practitioners or incorporated conveyancing firms under the Lawyers and Conveyancers Act 2006 should be paying agents for RLWT. This is because the paying agent is not jointly and severally liable for the RLWT debt and the compliance tools available to the Commissioner include the ability to report the RLWT agent to the appropriate professional body. It is expected that the professional body would take appropriate action in relation to the agent's non-compliance.

If the vendor does not have a conveyancer, the purchaser's conveyancer is the paying agent. This is provided for in section RL 2(2). If neither the vendor nor purchaser has a conveyancer, the purchaser is the paying agent. This is provided for by reading part (b) of the definition of conveyancer into section RL 2(2).

Associated persons

Under new section RL 3, if the vendor and purchaser are associated persons, the vendor is not liable to pay RLWT. Instead, the purchaser must withhold the requisite amount of RLWT and pay this to the Commissioner.

In this case, the purchaser has a withholding tax obligation under section BE 1 and the standard requirements for other withholding taxes apply.

The purchaser is *not* precluded from using the services of a conveyancer or lawyer to fulfil their RLWT obligations. However, this would be a contractual relationship between the purchaser and conveyancer that is not specifically provided for in legislation.

Paying agent is not the vendor's agent for other purposes

While the paying agent is considered to be the vendor's agent for the purposes of RLWT, new section RL 2(3) ensures that the paying agent is not considered to be the vendor's agent more generally, just because of their role as the RLWT agent. For example, the paying agent is not treated as the vendor's agent for income tax purposes.

New section RL 2(4) ensures that a paying agent who is only the vendor's agent in relation to RLWT is not subject to sections HD 2 to 4, which relate to agents.

No liability for underlying RLWT

New section RL 2(5) provides that a paying agent is not jointly and severally liable in relation to the vendor's RLWT debt, despite their obligation to satisfy the vendor's RLWT liability.

They may, however, be liable for the RLWT debt, if they have retained the RLWT amount from a residential land payment amount and have failed to pay the retained RLWT to the Commissioner.

New section RL 2(6) provides that the rules relating to penalties as set out in the Tax Administration Act 1994 apply. Further detail can be found in the section titled "When RLWT obligations not met".

Cost recovery by paying agent

While it is not specified in legislation, an RLWT agent is not precluded on a contractual basis from recovering the costs incurred in satisfying the vendor's RLWT obligations.

Calculating RLWT

Calculation steps

There are three calculation steps for RLWT, with the amount of RLWT payable being the lowest amount calculated. The third calculation step includes a deduction for a mortgage with a New Zealand-registered bank or non-bank deposit taker. This part of the third calculation step is only available when the vendor's conveyancer or solicitor is the paying agent.

New section RL 4 provides that the amount of RLWT to be paid is the **lowest** of the following three calculations:

- 33% (or 28% if the vendor is a company that is not acting as a trustee) × (current purchase price – vendor's acquisition cost) (set out in section RL 4(2)); and
- 10% × current purchase price (set out in section RL 4(4)); and
- current purchase price – security discharge amount – outstanding local authority rates (set out in section RL 4(6)).

New section RL 4(3)(b) defines "current purchase price" as the total price agreed by the vendor and purchaser for the disposal of the residential land that the residential land purchase amount relates to. This figure therefore includes deposits and part-payments. New section RL 4(3)(c) defines the "vendor's acquisition cost" as being the purchase price paid by the vendor for their acquisition of the residential land being disposed of.

It is expected that the vendor's acquisition cost is generally available from Quotable Value and the paying agent should be able to reasonably rely on this figure. If the vendor does not believe this is the correct acquisition price, they would need to provide the RLWT agent with sufficient evidence of a different acquisition price – for example, the original acquisition contract.

The current purchase price should be found in the agreement for sale and purchase between the vendor and purchaser. If, upon settlement, the parties agree to reduce the agreed purchase price, then this reduced purchase price is the figure that should be used to calculate RLWT. This may occur, for example, if the vendor has failed to carry out repairs prior to settlement, and instead, the purchaser takes responsibility for the repairs.

Example

Virginia is an offshore RLWT person who agrees to sell her residential property in Tauranga to Thomas. Thomas pays a $100,000 deposit and another $400,000 upon settlement. In determining Virginia's RLWT liability, the "current purchase price" is $500,000. Virginia originally acquired the residential property for $350,000. The "vendor's acquisition cost" for the purposes of determining Virginia's RLWT liability is $350,000.

Virginia does not have a mortgage on the property and she has no outstanding rates.

RLWT calculated using the formula in section RL 4(2) is 33% × ($500,000 – $350,000), or $49,500. RLWT calculated using the formula in section RL 4(4) is 10% × $500,000, or $50,000. Therefore the amount of RLWT payable is $49,500.

The obligation to pay RLWT is not restricted to instances when consideration for the property is paid in cash. In-kind consideration may form part of the transaction and the situation will be monitored to ensure that RLWT obligations are not evaded or avoided through the use of non-cash consideration, as this could raise concerns under the general anti-avoidance rule in section BG 1 of the Income Tax Act 2007. RLWT should be calculated with respect to the total consideration for the residential land. While a paying agent is not liable for the underlying amount they did not withhold, they may be subject to shortfall penalties depending on their level of culpability. The section titled "When RLWT obligations not met" sets out the different types of penalties in further detail.

An option to acquire land is included in the definition of "an interest in land" so this means the payment of an option fee is within the scope of RLWT.

The prices used to calculate RLWT should be net of GST, if any. Whether GST has been levied in relation to a transaction is determined by the Goods and Services Tax Act 1985.

In some cases, the sale may be zero-rated for GST purposes if both the recipient and supplier are GST registered and the recipient is acquiring the goods with the intention of using them for making taxable supplies and the land is not intended to be used as the principal place of residence of the recipient. In addition, there is a specific provision under the GST rules relating to instances where an agent and nominated purchasers have different GST registration statuses, whereby the zero-rating rules look through the agent to the nominated purchaser. Whether the transaction is zero-rated for GST purposes is a matter of fact as the recipient is required to provide written information to the supplier under the GST rules so the supplier can determine if GST should be zero-rated.

For further information on the zero-rating of land supplies for GST purposes, see the *Tax Information Bulletin* item for the Taxation (GST and Remedial Matters) Act 2010 (Vol 23, No 1).

To maintain the integrity of the RLWT and the broader tax system, RLWT generally needs to be paid before other disbursements that are made out of a residential land purchase amount. In most cases, this means the disbursements made at the time of settlement, which normally appear on the settlement statement. However, a real estate agent's commission is normally paid out of the deposit, before the payment of a residential land purchase amount – this can continue to be paid before RLWT.

The third calculation set out in section RL 4(6) recognises that there are certain bona fide situations when absolute priority of RLWT could delay or prevent settlement from occurring. In particular, these would be the payment of certain New Zealand mortgages and the vendor's portion of outstanding local authority rates.

If the two calculations set out in section RL 4(2) and (4) would leave insufficient funds for the vendor to discharge their mortgage obligation with a New Zealand-registered bank or non-bank deposit taker and/or their outstanding local authority rates, the third calculation allows for RLWT to be reduced to the extent required to pay the mortgage and outstanding rates.

"Security discharge amount" is defined in section RL 4(7) and (8) as the total amount required by a New Zealand-registered bank or non-bank deposit taker (as licensed under the Non-bank Deposit Takers Act 2013) to discharge the mortgage or other security over the residential land being disposed of. A full list of registered banks and licensed non-bank deposit takers is published by the Reserve Bank of New Zealand. The list of registered banks is available at **rbnz.govt.nz/regulation-and-supervision/banks/register** and the list of licensed non-bank deposit takers is available at **rbnz.govt.nz/regulation-and-supervision/non-bank-deposit-takers/register**

Note that the mortgage reduction part of the third calculation step is only available when the paying agent is the vendor's conveyancer or solicitor.

The reduction of RLWT payable for mortgages held with a New Zealand registered bank or a New Zealand non-bank deposit taker licensed under the Non-Bank Deposit Takers Act 2013 was inserted in response to consultation on the original issues paper, and concerns that the payment of RLWT could prevent settlement from occurring in some cases. By limiting the provision to mortgages held with New Zealand registered banks and non-bank deposit takers, the Government is more readily able to identify and react to any abuse as it is better equipped to monitor the regulatory environment in which the bank or non-bank deposit taker is operating. The situation is being monitored to ensure that it is not used to undermine the integrity of the RLWT and the broader tax system.

If the vendor's conveyancer is not the paying agent, the third calculation set out in section RL 4(6) effectively becomes "current purchase price – outstanding local authority rates".

The "outstanding local authority rates" component of the formula in section RL 4(6) is the amount of local authority rates in relation to the property that is still to be paid by the vendor for the period of ownership before the disposal. This is because under the Local Government Act 2002, unpaid rates amount to a charge on the land which has priority ahead of any mortgage. This reduction is available regardless of who the RLWT agent is.

It is not appropriate to extend the provision to other mortgages or other disbursements, even those that would be tax deductible for the vendor. To do so could undermine the tax system and it would be difficult for conveyancers who are not tax specialists to determine what payments are tax deductible.

If there are other charges that are being cleared as part of the settlement process – for example, unpaid body corporate levies or a loan held with a party that is not a licensed security holder, the RLWT agent has a number of possible courses of action if this leaves insufficient funds to pay the full amount of RLWT. For example, they may require the vendor to pay the additional funds to ensure those payments can be made. For further information on civil and criminal penalties, refer to the section titled "When RLWT obligations not met".

It is important to note that RLWT is simply on account of income tax and to the extent that RLWT has been over-withheld relative to the vendor's final income tax liability, a refund is available from Inland Revenue.

Example

Consider the previous example of Virginia and Thomas. Recall that the RLWT calculated using the methods set out in section RL 4(2) and (4) will be $49,500 and $50,000.

However, now Virginia has a mortgage with a New Zealand bank for $460,000. In addition, Virginia has outstanding rates of $360 owing to her local council. Since Virginia's conveyancer is the paying agent, the third calculation method set out in section RL 4(6) is relevant for both the mortgage and the local authority rates.

Using the third calculation method in section RL 4(6), the amount of RLWT calculated is $500,000 – $460,000 – $360, or $39,640. As this is less than $49,500 and $50,000, $39,640 is the amount of RLWT payable.

As discussed in the section titled "When RLWT applies", rollover relief is provided in the bright-line test under section FB 3A when there is a transfer of property from one spouse or partner to the other under a relationship property agreement following the breakdown of a relationship. The transferee generally takes on the cost base of the transferor – that is, they are considered to have acquired their recently acquired portion at the same time for the same cost as when the transferor originally acquired the property. This means that for the purposes of the RLWT rules, when there is a transfer of residential land on a settlement of relationship property, the "current purchase price" for the transferor (as the "vendor" in this situation) under section RL 4(3)(b) should be the same as the "vendor's acquisition cost" in section RL 4(3)(c) and when the transferee eventually disposes of the property, the "vendor's acquisition cost" is what the transferor acquired the property for. The result is that the calculated amount of RLWT for the transfer under the relationship property settlement is nil, but depending on the circumstances, the reporting requirements for RLWT may still apply.

Co-owners

As discussed in the section titled "When RLWT applies", where the vendors hold the property jointly (for example, as part of a partnership, as tenants in common, or as a joint tenancy), the offshore status of each partner or co-owner is considered individually and then RLWT applies to the offshore RLWT person's share in the property. This is provided for in section RL 1(3).

In the case of a partnership, RLWT applies according to the income interests held by offshore RLWT persons. To enable the RLWT agent to do this, the partners must provide the RLWT agent with a copy of the partnership agreement or a statement regarding their income interests in the partnership. The partners, in providing information about their income interests in the partnership, are providing information in relation to a tax law, so if they knowingly provide incorrect information, they will be subject to criminal penalties.

For other co-ownership situations, the RLWT agent can assume that the property is equally divided between co-owners, unless evidence to the contrary is provided to the RLWT agent.

The retained or withheld RLWT amount is then allocated by the RLWT agent to the appropriate offshore RLWT persons when the RLWT is passed on to the Commissioner. Further information on this can be found in the section titled "Information requirements".

Example

Hannah and Jack own a residential property as joint tenants, which they are selling within two years of acquisition. Jack is an offshore RLWT person and Hannah is a New Zealand citizen who has been physically present in New Zealand within the past three years. For the purposes of RLWT, their respective shares in the property are 50 percent each.

The RLWT agent calculates the RLWT applying to the whole transaction as $25,000. This means that only $12,500 (being 50 percent of $25,000) needs to be retained from the settlement funds to be paid to the Commissioner of Inland Revenue. The RLWT agent allocates the $12,500 to the IRD number provided by Jack.

Part-payments

A "residential land purchase amount" is defined in section YA 1 as an amount paid or payable for the disposal of the residential land in question, but excludes deposits and part-payments as long as all deposits and part-payments total in aggregate less than 50 percent of the purchase price for the land.

It is intended that the RLWT obligation arises as soon as that 50 percent threshold has been met. In most situations this should arise upon settlement, when the bulk of the purchase price becomes payable by the purchaser.

However, there may be situations when a number of part-payments are made by the purchaser, rather than one small deposit and then the remaining outstanding amount paid upon settlement. This may result in insufficient funds being available to pay the full amount of RLWT each time there is a residential land purchase amount. In this case, section RL 4(1) provides that the RLWT to be paid or withheld for each residential land purchase amount is capped at the amount of the relevant residential land purchase amount. Effectively, this allows RLWT to be paid in instalments and the due date is set in relation to each instalment.

This means that as soon as the 50 percent threshold is met, the RLWT agent must pay the **full** amount of each subsequent residential land purchase amount to the Commissioner as RLWT until the total amount of RLWT calculated under section RL 4(2), (4), or (6) has been paid.

Example

Stella purchases a residential property from Nicola for $500,000. Stella agrees to pay in 20 instalments of $25,000 each. Nicola is an offshore RLWT person and purchased the property for $400,000 one year earlier. Nicola has a mortgage with a New Zealand bank in relation to the property for $300,000 and no outstanding local authority rates. The RLWT agent calculates the amount of RLWT in relation to the property as being $33,000.

The first nine part-payments made by Stella do not meet the definition of a residential land purchase amount. However, the 10th part-payment constitutes a residential land purchase amount as together, the first 10 part-payments equal 50 percent of the total purchase price. The subsequent part-payments also constitute residential land purchase amounts.

The RLWT agent pays $25,000 from the 10th part-payment to the Commissioner because this is the maximum amount available from the relevant residential land purchase amount. The remaining $8,000 is paid from the 11th part-payment. The due date for the $25,000 payment of RLWT is set in relation to the date of the 10th part-payment and the due date for the $8,000 payment of RLWT is set in relation to the date of the 11th part-payment. The RLWT agent is not required to pay RLWT from the remaining part-payments as the total amount of calculated RLWT has been satisfied once they have made the payment of $8,000 to the Commissioner.

Information requirements

New section RL 1(6) of the Income Tax Act 2007 and new sections 54B and 54C of the Tax Administration Act 1994 set out the information requirements in relation to RLWT obligations.

New section RL 2(7) of the Income Tax Act 2007 provides that a paying agent is able to "reasonably rely" on the information provided to them by the vendor. Note that this ability to reasonably rely on information provided by the vendor is only available to paying agents, but not withholding agents.

Information to be provided by vendors to RLWT agents

New section 54C of the Tax Administration Act 1994 sets out the information that vendors are required to provide to the RLWT agent so that the agent is able to fulfil their RLWT obligations. At the time of writing, the IR1101 form is the form that must be completed and provided to fulfil any obligations under section 54C.

The information provision requirements in section 54C of the Tax Administration Act 1994 only apply if the vendor is within the two-year bright-line period and the residential land being disposed of was acquired on or after 1 October 2015. An amendment has been made to the definition of "bright-line date" in section YA 1, so that the calculation of the two-year period for the purposes of RLWT is the same as the bright-line test.

The calculation of the two-year period in new section 54C(1) of the Tax Administration Act 1994 is almost identical to section CB 6A(1) of the Income Tax Act 2007 in the bright-line test. The only exception is that section CB 6A(1)(a)(ii) is not required in the context of the RLWT, as it relates to land outside New Zealand. The bright-line date is defined in new section CB 6A and is discussed in further detail in the section titled "When RLWT applies".

Essentially, the vendor only needs to provide information if the bright-line date (in standard scenarios, the date of the agreement for sale and purchase) is within two years of the date on which the instrument to transfer the land to the person was registered under the Land Transfer Act 1952 (or if there has not been a registration yet, the date on which they acquired the land).

However, the vendor is required to declare in the IR1101 form under section 54C(5)(c)(ii) whether RLWT applies to the disposal and the RLWT agent should check whether RLWT does in fact apply – particularly if the paying agent is to "reasonably rely" on the information and documents provided by the vendor. If a paying agent is able to reasonably rely on the information provided, they will not be liable for a penalty under part 9 of the Tax Administration Act 1994.

The RLWT agent should be able to fairly easily determine on their own whether the vendor is within the two-year bright-line period, with little input from the vendor. This is because in most cases, the start-date of the two-year period is the date on which the instrument to transfer the land to the vendor was registered under the Land Transfer Act 1952, which is readily available on Landonline to conveyancers, and also on certain websites like Quotable Value.

If the RLWT agent is unable to find the title registration date because the instrument to transfer the land to the person is not registered on or before the bright-line date, the RLWT agent should ask the vendor for the acquisition date, and to reasonably rely on this information, certain documents may need to be provided. If this date is not provided by the vendor, the RLWT agent should assume that the vendor is within the two-year period for the purposes of RLWT.

The end-date or bright-line date is, in most cases, the date on which the person enters into an agreement for the disposal of the residential land. This date should be available to both the vendor's and purchaser's conveyancers from the agreement for sale and purchase for the vendor's disposal.

In a standard scenario when a prospective purchaser makes an offer on a house, but the offer is conditional on the purchaser obtaining satisfactory financing and/or a builder's report, the vendor's bright-line date is the date on which they accept the purchaser's conditional offer, not when the agreement goes unconditional. This is discussed in further detail in the section titled "When RLWT applies".

If the RLWT agent determines that the vendor is outside the two-year bright-line period, RLWT does not apply and the vendor does not need to provide further information as part of the IR1101 form to the RLWT agent under section 54C.

If the RLWT agent determines that the vendor is within the two-year bright-line period, the vendor is required to complete the IR1101 and provide accompanying documents under section 54C.

While the section 54C information requirements must be complied with if the vendor's bright-line period is within two years, in some cases it may be simpler for the vendor to provide their completed IR1101 form and accompanying documents before the bright-line period is determined. As three conditions must be met for RLWT to apply, it may, in some cases, be easiest to first determine whether the person is an offshore RLWT person, in some cases, the two-year disposal requirement, and in other cases, whether the land being disposed of is residential land.

For example, it may be straightforward if the vendor is a New Zealand citizen or holder of a residence class visa, and is physically present in New Zealand to sit down with their RLWT agent in New Zealand, complete their 54C form and show the RLWT agent their New Zealand passport or evidence of their residence class visa. The RLWT agent must take a copy of the passport or visa, but this (along with their physical presence) is sufficient to prove that the vendor is not an offshore RLWT person and that RLWT does not apply to the transaction. Sometimes, when a New Zealand citizen who is not an offshore RLWT person and does not have a New Zealand passport, an RLWT agent may consider that in order to reasonably rely on the statement that the vendor is not an offshore RLWT person, they need to see the vendor's birth certificate and government-issued photographic identification.

A paying agent can rely on information and accompanying documents provided by the vendor under section 54C, as long as their reliance on the information and the documents is "reasonable". This is provided for in section RL 2(7) of the Income Tax Act 2007. For example, this means that a paying agent is entitled to rely on the statement that the vendor is not an offshore RLWT person, unless there are reasonable grounds for doubt – for example, if it appears that the passport has been altered or the vendor is unable to provide their New Zealand passport or residence class visa.

If the vendor claims they are not an offshore RLWT person, but does not provide evidence to support this claim, relying on the statement would not be "reasonable". This is because there is an inherent incentive for an offshore RLWT person to claim that they are not an offshore RLWT person, to avoid paying RLWT.

If the vendor is required to provide information under section 54C, section 54C(3) provides that the vendor must provide the information prescribed by the Commissioner of Inland Revenue (including any accompanying documents) in the form prescribed by the Commissioner before a residential land purchase amount is made. In a standard scenario, this generally means that the IR1101 needs to be provided before the purchaser is required to pay the settlement funds to the vendor. This ensures that the RLWT agent has all the necessary information and documentation required to determine if RLWT applies.

If the IR1101 form and accompanying documents are not provided before the payment of a residential land purchase amount, the RLWT agent may assume the vendor is an offshore RLWT person and therefore withhold RLWT if the other requirements for withholding have been met (New Zealand residential land being disposed of within the two-year bright-line period). An exception to this would be where the RLWT agent has reasonable grounds for establishing that the vendor is not an RLWT person – for example, a long-standing client relationship such that the RLWT agent knows the vendor is not an offshore RLWT person.

Section 54C(5) provides that the minimum information required by the Commissioner of Inland Revenue to be provided by the vendor consists of:

- their full name and address;
- their IRD number;
- whether they are an offshore RLWT person; and
- if they are an offshore RLWT person, whether they and the purchaser are associated persons and whether the disposal would be subject to RLWT – that is, if the disposal would be income under the bright-line test, ignoring the main home exclusion and other land taxing provisions.

Any additional information specifically required is set out on the IR1101 form prescribed by the Commissioner of Inland Revenue.

Information provided under section 54C, including on the IR1101 form, is information provided in relation to a tax law, so the person signing the form could be subject to criminal penalties if they knowingly provide false information.

Section 54C(4) requires the vendor to provide relevant and appropriate documents as prescribed by the Commissioner, to support the information they have given under section 54C(5) – for example, in relation to the assertion that the disposal would not be income under the bright-line test, ignoring the main home exclusion and other land taxing provisions. If a vendor is claiming that RLWT does not apply, for whatever reason, they must provide documentation to support this assertion.

If a vendor states that they *are* an offshore RLWT person (and therefore subject to RLWT, depending on whether other requirements have been met), there is no need for the vendor to provide accompanying documents and evidence to support the statement that they are an offshore RLWT person.

However, if a vendor states that they are *not* an offshore RLWT person, accompanying documents must be provided. This is to allow the paying agent to "reasonably" rely on the information provided to them by the vendor. It would not be reasonable to rely on a claim that the vendor is not an offshore RLWT person without sufficient supporting evidence.

If the vendor can show the RLWT agent their New Zealand passport or residence class visa, the RLWT agent can take a copy and rely on this as evidence of their client's onshore status. If the vendor is unable to meet the RLWT agent in person, a certified copy of the vendor's New Zealand passport or residence class visa may need to be provided for the documents to be reasonably relied upon by a paying agent, in addition to evidence of physical presence within New Zealand during the requisite timeframe.

Where there are a number of vendors for a given disposal, for example, in the case of co-owners and partnerships, each co-owner or partner needs to separately provide information under section 54C in their own IR1101. This is so the RLWT agent can calculate the correct amount of RLWT and allocate it to the appropriate vendors.

Example

Hannah and Jack own a residential property as joint tenants, which they are selling within two years of acquisition. For the purposes of RLWT, 50 percent of the proceeds belong to Hannah and the remaining 50 percent belongs to Jack, even though they each own an undivided share in the property.

Jack is an offshore RLWT person and Hannah is a New Zealand citizen who has been physically present in New Zealand within the past three years. They each complete an IR1101 form and provide these to the RLWT agent. Hannah and Jack are not physically present in New Zealand at the time of the sale, Hannah also provides a certified copy of her passport and evidence that she has been in New Zealand.

The RLWT agent calculates the RLWT applying to the whole transaction as $25,000. As 50 percent of the proceeds belong to Hannah and the remaining 50 percent belong to Jack, only $12,500 (being 50 percent of $25,000) needs to be retained from the settlement funds to be paid to the Commissioner of Inland Revenue. The RLWT agent allocates the $12,500 to the IRD number provided by Jack in his section 54C form.

To provide a statement under section 54C of the Tax Administration Act 1994 that a non-natural person vendor is *not* an offshore RLWT person, section 54C(6) requires that the information and documents provided under section 54C must be verified by a natural person who is not an offshore RLWT person themselves and is:

- a director, in the case of vendor companies and look-through companies;
- a general partner of the partnership, in the case of vendor limited partnerships; and
- a trustee of the trust, in the case of vendor trusts.

In the case of other entities or arrangements, the equivalent of a non-offshore director is required to provide the statement, if the entity or arrangement is claiming that it is not an offshore RLWT person.

Only one person is required to verify the information and documents provided under section 54C, as long as they meet the requirements of section 54C(6).

A paying agent can "reasonably" rely on the director, general partner, or trustee's statement under section 54C on the offshore status of the entity without personally looking into the shareholding of the company. However, they must be satisfied that the person making the statement is not an offshore RLWT person themselves. This means the person completing the IR1101 form on behalf of the entity or arrangement must provide evidence of their New Zealand citizenship or residence class visa and presence in New Zealand in the same way that a natural person vendor does. For example, they could meet with the RLWT agent in person and show them their New Zealand passport. However, in some cases this may not be practical and providing a certified copy may be more appropriate.

The rationale is that it would sometimes be difficult to provide evidence of the offshore status of all shareholders. For example, companies may be widely held, but the paying agent could reasonably rely on the person's statement if they are satisfied that the person is not an offshore RLWT person. Furthermore, as the non-offshore director, general partner, or trustee would be providing information in relation to a tax law, they would be subject to criminal penalties, if they knowingly provide false information.

It was not considered appropriate to allow an offshore RLWT person to provide a statement under section 54C stating that an entity or arrangement is not an offshore RLWT person. This approach ensures that the RLWT rules maintain their integrity and appropriate follow-up action can be easily taken by the Commissioner in the event that information provided by the director, general partner or trustee is incorrect.

If no director, general partner or trustee who is not an offshore RLWT person can verify the information provided under section 54C, the outcome is as though no information has been provided.

In the case of a mortgagee sale, for example, the vendor (the mortgagor) is still required to provide the requisite information under section 54C. The standard consequences apply if the required information is not provided.

Information to be provided by RLWT agents to the Commissioner of Inland Revenue

Section 54B of the Tax Administration Act 1994 requires RLWT agents to provide a statement detailing their RLWT withholding obligations at the time they pay RLWT to the Commissioner. This is to enable the Commissioner to match the payment of RLWT by the RLWT agent to the appropriate vendor.

As previously discussed in the section titled "New tax type: Residential land withholding tax", the RLWT agent is permitted to pay amounts of RLWT to the Commissioner either on a monthly basis (by the 20th of the month following the month in which RLWT was withheld or retained) or a transaction-by-transaction basis.

The form of the section 54B statement is prescribed by the Commissioner and includes, at a minimum, the IRD number of the taxpayer to whom the RLWT should be allocated, the amount of RLWT calculated under section RL 4 of the Income Tax Act 2007 and the amount of RLWT ultimately retained and paid to the Commissioner.

Where an amount of RLWT has been retained or withheld on behalf of a number of offshore co-owners or partners in relation to a particular transaction, the RLWT agent must allocate the appropriate amount of RLWT to each of the offshore co-owners or partners using the IRD numbers provided to them under section 54C.

Note that section 54B(2) provides that when RLWT applies, but the calculation methods set out in section RL 4 have resulted in a nil amount of RLWT to be paid, the RLWT agent must still provide a 54B statement to the Commissioner. This may happen, for example, if the vendor's acquisition cost exceeds the current purchase price, or a New Zealand mortgage has reduced the amount of RLWT payable to zero. This enables more efficient data matching with information collected by Land Information New Zealand as part of the land transfer tax statement to determine that RLWT obligations have been considered and met.

It also allows the Government to monitor the RLWT rules for any potential abuse of the rules and respond appropriately.

Section 54B(1) provides that the Commissioner may also allow further time for paying and withholding agents to furnish their RLWT statements. However, this may affect a vendor's ability to apply for a refund if he or she wants to file an interim claim shortly after the disposal, as refunds for an interim claim are generally not issued until the payment of RLWT to the Commissioner is reconciled with the vendor's account.

Information retention and the Privacy Act 1993

New section 54C(7) of the Tax Administration Act 1994 requires anyone who receives information under section 54C of the Tax Administration Act 1994 to retain that information for at least seven years. The seven-year period is a standard feature of record-keeping requirements. This rule applies to an RLWT agent who receives information under this section, irrespective of whether RLWT is ultimately retained or withheld.

However, if the RLWT agent is the purchaser themselves, they are not required to retain the information if they provide to the Commissioner a copy of the information given to them by the vendor within one month of receiving it. This is because they are not a professional conveyancer or lawyer and may not be aware of their record-keeping obligations.

The provisions of the Privacy Act 1993 also apply to information collected under section 54C of the Tax Administration Act 1994. When the recipient of the information is a conveyancer, there are also professional obligations regarding confidentiality.

Interim claims

Section RL 6 of the Income Tax Act 2007 and section 54D of the Tax Administration Act 1994 provide for the new interim claim process. This allows vendors who have had RLWT withheld to calculate their income tax liability in relation to land before the end of the relevant income year, and obtain a refund when the amount of RLWT paid exceeds the person's income tax liability.

The interim claim is not a full and final income tax return and the vendor is still required to file an income tax return at the end of the income year. This is because the purpose of the interim claim process is to relieve cashflow pressures for the vendor.

As previously discussed, section LB 6B provides a tax credit for the year in which a person disposes of the residential land equal to the amount of RLWT paid. Generally, this tax credit is used to offset the person's income tax liability arising from the disposal of residential land. If the amount of RLWT paid exceeds the person's income tax liability for the disposal of residential land, section LA 6 provides that the credit can be used to satisfy the person's other income tax liabilities. If an excess RLWT credit still exists, a refund may be given.

To retain the integrity of the RLWT rules, and to prevent fraudulent refunds from being processed, the vendor is provided a credit only for the amount of RLWT that has actually been paid to the Commissioner when the interim claim application is processed.

The Tax Administration Act 1994 already provides for special returns in specific circumstances (for example, an early return when a taxpayer no longer has an enduring relationship with New Zealand and will not derive any further income that will be taxed in New Zealand), and sections 79 and 80 allow the Commissioner to require the furnishing of annual returns and other returns in addition to those already prescribed. However, section 54D has been inserted to specifically provide for the interim claim process for RLWT.

Under section RL 6(1)(a), the Commissioner may refund an amount of RLWT to the extent that an RLWT tax credit is a surplus credit when looking only at the person's income and deductions for land for the tax year.

To calculate the amount of the surplus credit, the company tax rate (currently 28%) is used for companies, and the top marginal tax rate (currently 33%) is used for individuals. The rationale for using the top rate for individuals is that the interim claim process only takes into account the person's income for land and does not consider the person's other income for the year. Using a lower marginal tax rate (for example, the lowest marginal rate of 10.5%) could result in a larger refund being issued than the person would be entitled to if they have other income that may be taxed in New Zealand.

In addition, for a refund to be issued as an interim claim, section RL 6(1)(b) requires that the person must not have any outstanding tax obligations under the Inland Revenue Acts. This is because the person's tax debts should be paid before a refund is issued.

A person may lodge an interim claim regardless of whether they were eligible for an RLWT exemption certificate.

Under sections RL 6(1)(c) and 54D of the Tax Administration Act 1994 the person must provide information using the interim claim form prescribed by the Commissioner for an interim claim to be processed.

The information that must be provided is set out in section 54D(1). At a minimum it must include the person's income and deductions relating to land for the part of the income year until one month after the disposal of residential land for which RLWT was paid. This means all income relating to land for the income year to date, not just income relating to the disposal from which RLWT was withheld or retained, must be provided. During development of the policy it was not considered necessary to require the person to disclose all income and deductions for the year to date, but equally, it was considered inappropriate to limit the "snapshot" of the person's tax position captured by the interim claim only to the RLWT transaction.

Example

Phoebe is an offshore RLWT person who sells three properties during the 2017 income year – one in May, one in August, and the other in September. All three disposals are taxable for Phoebe. Phoebe is liable for RLWT on the property sold in August. RLWT has been paid in relation to the sale made in August. Phoebe works out the amount of RLWT exceeds the tax to pay on the property sales. Phoebe prepares an interim claim using the form prescribed by the Commissioner and includes her income and deductions relating to all three sales. Phoebe also has salary and wage income that is taxable in New Zealand, but she does not include this income in her interim claim.

As it is possible that a person who has had RLWT paid in relation to a disposal qualifies for the main home exclusion, as part of the interim claim the person must also state whether or not they qualify for the main home exclusion in section CB 16A of the Income Tax Act 2007.

In addition, section 54D(1)(c) and (2) provides that the Commissioner may request further information and accompanying documents as part of the interim claim process. This will be clarified in further operational guidance.

When RLWT obligations not met

The standard penalties that apply to other withholding taxes also apply in the case of RLWT. This is despite RLWT not being a true withholding tax, as in most cases, paying agents are generally not jointly and severally liable for the RLWT that should have been paid.

If there are insufficient funds available to pay the full amount of RLWT due to other disbursements or a non-cash consideration, for example, a paying agent has several possible courses of action. They may, for example, require the vendor to pay the additional funds to ensure those payments can be made. While a paying agent is not liable for the underlying amount they did not withhold, they may be subject to certain penalties depending on their level of culpability.

Penalties

Under new section RL 2(6), the rules relating to penalties as set out in part 9 of the Tax Administration Act 1994 apply to paying agents as though they have failed to pay an amount of withholding tax equal to the amount of RLWT they failed to satisfy.

This means the general penalties rules that apply to withholding taxes (such as late filing penalties) also apply to RLWT, irrespective of whether the person required to satisfy RLWT is a paying agent or a withholding agent. No corresponding penalties provision is required for when the RLWT agent is a withholding agent as the penalties that apply to "true" withholding taxes are implicit through the addition of RLWT in sections BE 1(6), RA 6C(2) and RA 10(1)(a).

As discussed in the section titled "Information requirements", a paying agent is able to "reasonably rely" on information provided to them as part of a section 54C form. If a paying agent fails to retain an amount of RLWT from a residential land purchase amount because they have reasonably relied on the information provided to them under section 54C by the vendor, section RL 2(7) provides that the paying agent is not liable for a penalty under part 9.

Generally, the main civil penalty that may apply is a shortfall penalty. An RLWT agent may be liable for shortfall penalties if they take a tax position that is inaccurate and satisfies one of the following:

- not taking reasonable care;
- gross carelessness;
- an abusive tax position; or
- evasion.

Penalties increase in proportion to the seriousness of the breach and apply across different tax types. Official guidance and interpretation is available on how the Commissioner applies each type of shortfall penalty. In addition, there are provisions which determine to what extent taxpayers may be eligible for a reduction in the shortfall penalty.

When an RLWT agent retains and pays an amount of RLWT to the Commissioner, but this is less than the amount calculated using the three calculation steps, shortfall penalties may apply to the shortfall. (That is, the difference between the calculated amount and what is actually paid to the Commissioner, depending on the RLWT agent's level of culpability the Commissioner considers was present in the transaction.)

Late payment penalties may also apply in the context of RLWT, but unlike shortfall penalties, they are applied automatically to the amount that should have been paid. The late payment penalties are set out in section 139B of the Tax Administration Act 1994.

When the RLWT agent is a true withholding agent (because the vendor and purchaser are associated persons), late payment penalties apply if the required amount of RLWT is not paid to the Commissioner by the due date (the 20th of the following month). While the new legislation is silent on this point, use-of-money interest (UOMI) should also apply.

Under new section RL 2(6)(a), a RLWT agent who is a paying agent and has subtracted or retained *an* amount of RLWT from a residential land purchase amount, but has failed to pay the calculated RLWT to the Commissioner, late payment penalties apply. Late payment penalties generally continue to accrue until the core debt (in this instance the RLWT) has been cleared. UOMI should also apply in this instance.

Under new section RL 2(6)(b), when the paying agent has *not* retained *an* amount of RLWT from the residential land purchase amount, late payment penalties do not apply. This is because in most cases, the paying agent is not liable for the underlying amount of RLWT and once they have released the funds to the vendor, they are not able to rectify their failure to retain and pay RLWT. While the new legislation is silent on this point, UOMI should not, in this situation, apply to the paying agent. However, as the RLWT liability and resulting debt is ultimately the vendor's, where penalties do not apply to the paying agent as a result of section RL 2(6)(b), they will instead apply to the vendor. UOMI will also apply to the vendor.

The correct legal result is that late payment penalties are calculated in relation to the amount of RLWT that should have been retained under section RL 4. In some cases, this may not equal the amount that the paying agent retained and subsequently paid to the Commissioner. In this case, late payment penalties should ultimately apply only to the amount they retained because they are unable to rectify their failure to retain the full amount as the funds will have already left their possession. However, this should be determined on a case-by-case basis to ensure the integrity of the RLWT rules is maintained. To achieve this result, the existing rules surrounding remission of penalties and interest apply so that the paying agent may be able to seek relief in appropriate circumstances.

When relief is sought, the paying agent must show they have retained what they claim to have retained and provide full information about why they have not retained and paid the correct calculated amount of RLWT. This enables the Commissioner to determine to what extent relief should be appropriately provided and to make an assessment on whether shortfall penalties should also apply.

Example

Manny is an offshore RLWT person whose bright-line period for the house he is selling is less than two years. RLWT therefore applies when Manny sells his house. Manny's paying agent is Evan. Evan calculates the amount of RLWT that needs to be retained from the proceeds of the sale to be $25,000. Evan only retains $20,000 from the settlement funds on 15 August, but then only pays $15,000 to the Commissioner on the due date of 20 September.

Evan is subject to late payment penalties, because he has not paid the full amount of RLWT to the Commissioner by the due date (20 September). Late payment penalties are automatically calculated based on the difference between what Evan paid ($15,000) and what Evan should have paid ($25,000). UOMI also applies.

While Evan can rectify his late payment in relation to the difference between the $15,000 and what he actually retained ($20,000), he is unable to rectify his late payment in relation to the difference between the $20,000 and $25,000 as the settlement funds have left his hands and he is not jointly and severally liable for the portion of the RLWT he did not retain.

Evan contacts Inland Revenue and provides information on the amount he did actually retain and why he did not retain the full amount that was calculated under the RLWT rules.

Late payment penalties and UOMI continue to accrue in relation to the retained $20,000 until Evan has paid to the Commissioner the full amount that he retained from Manny.

Late filing penalties are important in the context of RLWT because if an RLWT agent's section 54B statement is not received by the due date, it may negatively affect a taxpayer's ability to use their RLWT credit to offset their income tax liability arising from the disposal of residential land and obtain a refund from Inland Revenue as part of the interim claim process. Late filing penalties apply to tax types when the timely provision of information to the Commissioner is important (for example, employer monthly schedules and annual imputation credit account returns) and does not apply to withholding taxes such as RWT and NRWT as that information is not required until 31 May in the following year.

The possibility of having late filing penalties imposed encourages agents to provide RLWT statements by the due date. The imposition of late filing penalties in the context of RLWT is provided for in sections 139A(1), 139A(2)(iiic) and 139A(4). Section 139A(4) provides that the late filing penalty for RLWT statements is the same as that for employer monthly schedules – $250.

The RLWT agent may also be liable for criminal penalties. These are applied by a court of law. Criminal penalties include absolute liability offences, such as failing to keep documents required to be kept under the Tax Administration Act 1994. The different types of criminal penalties are set out in sections 143–148 of the Tax Administration Act 1994.

Liability for underlying RLWT

As noted previously, under new section RL 2(5), a paying agent is not jointly and severally liable in relation to the vendor's RLWT debt, despite their obligation to satisfy the vendor's RLWT liability. However, if a paying agent has retained RLWT from a residential land purchase amount, but has not paid the RLWT to the Commissioner, they are liable for the amount of RLWT they retained and did not pay to the Commissioner.

Example

In the example above with Evan as a paying agent, the amount of RLWT calculated is $25,000, but Evan only retains $20,000 and pays $15,000 to the Commissioner. Evan is not liable for the full $25,000, only the $20,000 that he did retain from Manny.

If the vendor and purchaser are associated persons, the purchaser is the withholding agent and is therefore liable for the underlying RLWT, in a similar way to standard withholding taxes.

Reporting to professional body

An amendment to section 81 of the Tax Administration Act 1994 has been made to allow the Commissioner of Inland Revenue to provide details of a RLWT agent to their relevant professional body when they have failed to fulfil their RLWT obligations. These professional bodies might include, for example, the New Zealand Law Society and the New Zealand Society of Conveyancers. This allows professional bodies to take appropriate action against members who do not comply with their legal obligations under the RLWT rules.

This is an important feature that supports the integrity of the RLWT rules, as paying agents are not liable for the underlying RLWT in most circumstances, so the exception from section 81 ensures there are sufficient consequences for RLWT agents who do not fulfil their legal obligations. However, it is expected that reporting to a professional body will only occur where the RLWT agent repeatedly or deliberately fails to correctly account for RLWT.

For the RLWT rules to retain their integrity and be effective, it is expected that the relevant professional body would take appropriate action against the member. This is why it is intended that only conveyancers and lawyers who are allowed to hold themselves out as such in New Zealand and are therefore a member of a professional body in New Zealand should be paying agents for the purposes of RLWT.

EXCEPTION FROM THE BANK ACCOUNT REQUIREMENT

Sections 24B and 24BA of the Tax Administration Act 1994

The new legislation introduces certain exceptions from the requirement for offshore persons to provide a fully functional New Zealand bank account number to the Commissioner of Inland Revenue when applying for an IRD number:

- Non-resident suppliers registering for New Zealand GST (including those who make a supply of remote services).
- The person has already had anti-money laundering (AML) verification undertaken by a New Zealand reporting entity.
- The person is a worker under the recognised seasonal employer scheme and they obtain a fully functional bank account within one month of arriving in New Zealand.

Background

From 1 October 2015, a person who is an "offshore person" must have a functioning New Zealand bank account in order to apply for an IRD number. The requirement to have a New Zealand bank account ensures that the AML identity verification requirements apply to offshore persons. The requirement was introduced as part of a suite of Budget 2015 changes to improve the overall integrity of the property tax rules.

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill as introduced provided an exception for non-resident suppliers of cross-border services and intangibles to ensure the requirement was not a barrier to registering and returning GST on these supplies.

At the select committee stage, some submitters noted that in certain circumstances there were unintended consequences when a person required an IRD number but had a limited physical presence in New Zealand. Accordingly, this exception was widened to include all non-resident suppliers who require an IRD number solely because they are a non-resident supplier under the GST Act. Additional exceptions were also included in the Act to ensure the bank account requirement does not apply when it would result in a duplication of AML verification, and to allow a grace period of one month in the case of workers under the recognised seasonal employer scheme.

Key features

Other non-resident suppliers registering for New Zealand GST

New section 24BA(1B) provides an exception for all non-resident suppliers registering for New Zealand GST as long as the IRD number is applied for solely because the person is a non-resident supplier under the GST Act. For many of these non-residents there are already a number of requirements that must be met for them to become registered. This reduces the identity verification risk.

The person has already had AML verification undertaken by a New Zealand reporting entity

Section 24BA(1C) provides an exception for persons who have already had AML verification under a reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

The person is a worker under the recognised seasonal employer scheme (RSE scheme) and obtains a fully functional bank account within one month of arriving in New Zealand

It is important that employees under the RSE scheme have their wages paid into a New Zealand bank account. However, in some cases there may be some delays in obtaining a New Zealand bank account.

New section 24BA(1D) and the related amendment to section 24B(3) provide for non-resident seasonal workers under the RSE scheme to use the NSW tax code for the first month of being employed in New Zealand regardless of whether they have provided the Commissioner with a fully functional New Zealand bank account number. Workers must provide a fully functional New Zealand bank account number to the Commissioner within this first month. This allows workers under the RSE up to one month to obtain a New Zealand bank account and notify the Commissioner.

If a person employed under the RSE scheme has not provided a bank account number to the Commissioner within a month of being employed in New Zealand, they will have tax withheld at the non-declaration rate of 45% until they obtain an IRD number.

Application date

These amendments came into force on 14 May, being the day after the date of enactment.

CHANGES TO THE STUDENT LOAN SCHEME

Sections 4, 5, 15, 27A-27E, 63, 68A-68C, 73 – 76, 79, 82, 83, 114, 114A, 146A, 155, 156, 169, 173, 176A, 185, 202, 209A, 213-215, 220, schedule 1, schedule 3, schedule 4 and schedule 6 of the Student Loan Scheme Act 2011; section MK2 of the Income Tax Act 2007; sections 22 and 81 of the Tax Administration Act 1994

The new legislation introduces the following changes to the Student Loan Scheme.

TRANS-TASMAN INFORMATION-SHARING REGARDING NEW ZEALAND STUDENT LOANS

Section 209A of the Student Loan Scheme Act 2011; section 81 of the Tax Administration Act 1994

Information-matching will be undertaken between Inland Revenue's student loan borrowers and the Australian Taxation Office database of Australian taxpayers to enable Inland Revenue to maintain up-to-date contact details for borrowers residing in Australia.

Background

One of the keys to collecting overdue student loan repayments is holding up-to-date contact details for defaulters. Not having contact details makes engaging with overseas-based borrowers, many of whom are believed to be living in Australia, difficult.

A successful match of borrower details against an entry in the Australian Taxation Office database of Australian taxpayers would allow Inland Revenue to receive up-to-date contact details for New Zealand student loan borrowers residing in Australia. Inland Revenue would then be able contact those individuals to keep them engaged with their loan obligations and, where appropriate, recover outstanding student loan repayment amounts.

The amendments will give effect in domestic law to the Arrangement for the Exchange of Information regarding New Zealand Student Loans, signed by the Commissioner of Taxation (Australia) and the Commissioner of Inland Revenue (New Zealand) in March 2015.

Key features

New section 209A sets out, in subsection (1), the purpose of the exchange of information, which is to facilitate the exchange of information between Inland Revenue and the Australian Taxation Office in order to verify contact details of New Zealand student loan borrowers, and to administer the student loan scheme in relation to borrowers who are, or may be, overseas-based.

Subsection (2) limits who in the Australian Taxation Office is authorised to receive the information from the Commissioner of Inland Revenue.

Subsection (3) prescribes the information that may be provided by the Commissioner of Inland Revenue.

The requirement in the Tax Administration Act 1994 for officers to maintain secrecy has also been amended by providing a new exception in section 81(4)(gbb).

The information exchange under the Arrangement required amendments to domestic law in both Australia and New Zealand. Accordingly, the Australian Government has made amendments in Australian domestic law to facilitate this exchange of information and allow the Australian Taxation Office to disclose protected information for this purpose. The relevant amendments are in the Australian Tax Administration Act 1953 (Item 8 in Table 7 in Division 355 of Schedule 1).

Application date

The amendment came into force on 14 May 2016, being the day after the date of enactment.

APPROVAL OF CHARITABLE ORGANISATIONS FOR STUDENT LOAN PURPOSES

Sections 4, 27A – 27E, 173, 176A, 215, schedules 1 and 6 of the Student Loan Scheme Act 2011; section MK2 of the Income Tax Act 2007

The authority for approval of charitable organisations for student loan purposes has been delegated to the Commissioner to give borrowers who volunteer overseas more timely access to interest-free loans.

Background

When student loan borrowers are volunteering overseas or working for a charitable organisation for a token payment, they may apply to be treated as New Zealand-based and eligible for write-off of interest on their student loans. However, the charitable organisation must itself be approved for the purposes of the scheme.

Previously, these charitable organisations had to be approved by Cabinet for the purposes of the student loan scheme interest write-off and listed in regulations. A student loan borrower's status of being treated as physically present in New Zealand and therefore eligible for interest write-off could not commence earlier than the date on which the organisation was listed in the regulations.

However, the process and the making of regulations was slow, so some borrowers did not gain the benefit of the interest write-off because the organisation was not approved and listed in the regulations before the borrower's volunteer term was completed. Delegating approval authority to the Commissioner will speed up the approval process so qualifying students will have more timely access to the interest write-off.

Key features

The new rules specify what is required for a charity to be listed for student loan purposes, relying on existing requirements in the Charities Act 2005 and the Income Tax Act 2007. The Commissioner may list a charity without an application by the organisation itself if she is satisfied that the organisation meets the criteria under section 27B.

The Commissioner is required to maintain and publish a charities list for these purposes and will have the power to de-list organisations that no longer meet the requirements.

When the Commissioner de-lists an organisation, student loan borrowers who have already been approved for interest write-off will remain eligible until they complete their volunteering assignment or reach the end of the 24-month approval period, whichever happens first.

The replacement definition of "charity" in section 4 of the Student Loan Scheme Act removes the reference to the regulations, which have been revoked, and refers instead to the list (of approved charities).

New section 27A requires the Commissioner to keep and publish a list of charities that have been approved. The list must include the date from which each charity's listing applies and the date of de-listing, if applicable.

New section 27B prescribes the primary matters with which the Commissioner must be satisfied before listing a charity. The criteria rely on the definition of "tax charity" in the Income Tax Act 2007 for the purposes of eligibility for exemption from income tax and the essential requirements for registration under the Charities Act 2005. Supplementary criteria will be set out in guidelines for the exercise of the Commissioner's discretion.

The application requirements are set out in new section 27C, allowing the Commissioner to seek more information if necessary, and to list those charities that qualify under section 27B. The Commissioner is also required to give an applicant prior advice of her intention to refuse a listing, with reasons, and allow the organisation time to rectify any deficiencies in their application. Applicants must be notified of the Commissioner's final decision.

For organisations that wish to be listed, or their advisers, there is no change from the current application process as set out on the Inland Revenue website at **www.ird.govt.nz/charitable-organisations/chart-orgs-sl-scheme/** except that applications must now be sent to:

Charities Team
Inland Revenue
PO Box 1147
Palmerston North 4440
New Zealand

Or email to C**harities.Queries@ird.govt.nz**

Under section 27D the Commissioner is able to list a charity even if no application has been made under section 27C. This is likely to occur when a borrower applies to be treated as being physically present in New Zealand while volunteering, but the organisation, although on the Charities Register or approved as a tax charity, has not yet been listed for student loan scheme purposes.

Section 27E allows the Commissioner to remove a charity from the list if she determines that the charity no longer meets the criteria for listing. The Commissioner is required to give a charity prior advice of her intention to de-list, with reasons, to allow the organisation time to make any arguments against the proposed decision and consider any such arguments before making and notifying the charity of her final decision.

The amendments to section 173 remove a decision made by the Commissioner (to refuse to list a charity or remove a charity from the list) from the process for disputing assessments under part 4A of the Tax Administration Act 1994. Instead, the decision can be challenged by the charity under new section 176A, which will bring the challenge under part 8A of the Tax Administration Act.

Clause 2(2) of schedule 1 has been replaced to clarify that an organisation must be included in the charities list before the Commissioner can grant a borrower's application for an interest write-off in respect of voluntary work for that organisation. Otherwise, if the voluntary work has already been completed, the organisation must have been listed for the period of that work.

Transitional provisions in new clause 20, part 4 of schedule 6, provide for charities already listed in the regulations to continue to be treated as qualifying charities and require the Commissioner to include them in the list referred to in section 27A.

The Student Loan Scheme (Charitable Organisations) Regulations 2011 have been consequentially revoked and the regulation-making power in section 215(b) has been repealed.

As a consequence of these changes, section MK 2 of the Income Tax Act 2007 is also amended to ensure that KiwiSaver member tax credits continue to be available to members of KiwiSaver schemes or complying superannuation funds who volunteer overseas and meet the requirements that apply to borrowers under the student loan scheme.

What do these changes mean for student loan borrowers?

There is no change to the application process for borrowers who are volunteering overseas. Those requirements are set out at **www.ird.govt.nz/studentloans/overseas/interest-free/**

However, the new rules will mean that if a borrower applies to be treated as being in New Zealand the approval process will be faster and they will get their interest relief earlier than under the previous process.

If the organisation the borrower is volunteering for is not listed for student loan purposes but it is already recorded as a tax charity, the approval will be automatic. Even if the organisation is required to prove that it meets the criteria for listing, it can be listed as soon as it provides that proof.

Borrowers who do not apply for interest relief until after they return to New Zealand can still benefit as long as the organisation was listed while the voluntary work was being carried out.

In all cases, the interest relief cannot begin earlier than the date on which the Commissioner approves the organisation for listing.

Example

Borrower A goes overseas to volunteer for Organisation C. When they have been away for 184 days, they are treated as overseas-based and interest begins to accrue on their student loan. After checking the information on the Inland Revenue website they apply to be treated as New Zealand-based. Organisation C is already recorded as a tax charity so the Commissioner immediately approves the listing for student loan purposes and interest relief for the borrower can start from that date.

Application date

The amendment came into force on 14 May 2016, being the day after the date of enactment.

TREATMENT OF OVER-RECOVERED COMMISSIONER DEDUCTIONS

Sections 63 and 68A-68C of the Student Loan Scheme Act 2011

The treatment of over-recovered deductions from a borrower's salary or wages has been rationalised so that the same treatment applies, regardless of whether they were standard deductions or additional deductions initiated by the Commissioner of Inland Revenue to recover some previous repayment shortfall.

Background

The Commissioner of Inland Revenue is able to require a New Zealand-based student loan borrower's employer to make additional deductions from the borrower's wages or salary to meet a previous shortfall in repayment obligations. In doing so, the Commissioner advises the employer of the total additional amount to be deducted. However, sometimes employers continue the additional deductions beyond the amount necessary to fully recover the shortfall. Although the Student Loan Scheme Act 2011 prescribed what the Commissioner must do when there is an over-deduction of standard deductions, it did not provide for over-recovery of additional deductions.

Key features

The amendments align the treatment of over-recovered additional deductions of student loan repayments with the treatment specified for over-recovery of standard deductions made for student loan repayments. This simplifies administration by having one standard process.

The replacement of the cross-heading above current section 63 makes it clear that the section applies only to standard deductions.

New section 68A defines a Commissioner over-deduction and sets out what a borrower can do when he or she believes there has been an over-deduction of additional deductions. The requirement for the Commissioner to respond is set out in section 68B.

Under section 68C, when the Commissioner identifies or determines that an over-deduction has been made, she is required to notify the borrower of the amount of the over-deduction, that it has been offset against the borrower's consolidated loan balance, and give the borrower the option of requesting a refund of the over-deducted amount within a specified timeframe. The time limit on requests for refunds is six months from the date of notification. If, however, another shortfall in repayment obligations is concurrently identified, the over-recovered amount will be offset against that shortfall.

Application date

The amendments came into force on 14 May 2016, being the day after the date of enactment.

NOTIFYING ADJUSTMENTS TO NET INCOME

Sections 4, 5, 73-76, 79, 82, 83, 114, 114A, 146A, 155, 156, 185, schedule 4 and schedule 6 of the Student Loan Scheme Act 2011

All borrowers with specified types of income are required to make adjustments to their net income to ensure accurate calculation of their repayment obligations. The means of doing so has been simplified to notifying the Commissioner rather than by formal declaration.

Background

Prescribed adjustments to net income were introduced in 2013, to ensure a borrower's repayment obligations more accurately reflected their ability to repay their loan.

Those provisions required only borrowers who are not required to file a return of income for income tax purposes to make a declaration of their adjusted net income. However, the use of the term "declaration" placed an unreasonable burden on borrowers to meet the requirements of the Oaths and Declarations Act 1957, including having the form witnessed by a person specified in section 9 of that Act.

In addition, the nature of adjusted net income amounts means that they are not required to be included in income tax returns because they are generally not subject to income tax. Borrowers who file income tax returns were effectively excluded from the requirements to provide details of their adjusted net income.

Key features

New section 73 introduces new defined terms to clarify that adjusted net income is made up of net income as defined in the Income Tax Act 2007, and any adjustments provided for in schedule 3 of the Student Loan Scheme Act 2011. New definitions of "adjusted net income", "schedule 3 adjustments" and "statement of adjusted net income" support the changes that require all borrowers with the relevant types of income to provide the necessary details.

A borrower may fulfil requirements of subsection 73(2) to make a statement of adjusted net income by filing a return of income only, notifying schedule 3 adjustments only, if they are not required to file a return of income, or filing a return of income and notifying schedule 3 adjustments.

Section 74 sets out when the section applies to New Zealand-based borrowers and the timing of required notification of schedule 3 adjustments.

Sections 75, 76, 79, 82 and 83 have been amended to reflect the new terminology.

New section 114 deals with the notification of schedule 3 adjustments by New Zealand-based non-resident borrowers, similar to the requirements under section 74.

Sections 114A, 146A, 155, 156, 185, and clauses 1(f) and 2(c) in schedule 4 of the Student Loan Scheme Act 2011 have also been amended to reflect the new terminology.

Application date

The amendments came into force on 14 May 2016, being the day after the date of enactment.

RETENTION OF ADJUSTED NET INCOME RECORDS

Section 202 of the Student Loan Scheme Act 2011; section 22 of the Tax Administration Act 1994

Student loan borrowers who have adjusted net income are now subject to the record-retention requirements of the Tax Administration Act 1994, and explicitly subject to the obligations set out in that Act relating to retention and disclosure of information.

Background

Borrowers with income for which they are required to file annual tax returns are automatically required to hold records as specified by the Tax Administration Act 1994. However, with the introduction of the adjusted net income provisions in 2013, borrowers should also have been required to retain records of the adjustments to their net income. This is necessary to allow Inland Revenue to review source records to ensure the correctness of assessments, either as a result of borrowers exercising their dispute or challenge rights, or through its own audit activities.

Key features

The amendments make student loan borrowers who have adjusted net income subject to the record-retention requirements of the Tax Administration Act 1994, and explicitly subject to the obligations set out in that Act relating to the retention and disclosure of information.

Section 15B of the Tax Administration Act sets out a taxpayer's obligations. To ensure there is no doubt that student loan borrowers are subject to these obligations, where appropriate, section 15B has been added to the list in section 202 of the Student Loan Scheme Act 2011 of provisions in the Tax Administration Act and Income Tax Act 2007 that apply to the Student Loan Scheme Act.

Section 22 of the Tax Administration Act requires taxpayers to keep business and other records. Student loan borrowers with adjusted net income are now subject to these requirements through the addition of paragraphs 22(2)(fc) and 22(2)(n).

Application date

The amendments came into force on 14 May 2016, being the day after the date of enactment.

MAIN INCOME EQUALISATION SCHEME DEPOSITS AND REFUNDS

Sections 4, schedule 3 and schedule 6 of the Student Loan Scheme Act 2011

Technical amendments will ensure that provisions relating to main income equalisation scheme deposits and refunds work as intended, including when a borrower's interest in a scheme is indirect, such as through a company or trust with which the borrower is associated.

Background

The main income equalisation scheme allows taxpayers carrying on an agricultural, fishing or forestry business to smooth their incomes for income tax purposes to deal with large fluctuations in income over several years. A deposit to a main income equalisation scheme is allowed as a deduction for income tax purposes. However, the effect of allowing the deposit as a deduction is to reduce a student loan borrower's income for student loan purposes when that income would have been available to the borrower to contribute to loan repayments. An adjustment is necessary to net income to add back the deduction for student loan purposes. The treatment extends to deposits made by the borrower or associated entities, such as companies or trusts.

To prevent double counting, refunds from the accounts (excluding interest earned on deposits) are not counted for student loan purposes when they are received. However, the previous rules relating to refunds did not extend to refunds to associated entities (companies or trusts) of the borrower, with the risk that the associated entities' refunds would be counted in a borrower's income for a second time.

In addition, the adding back of deductions for deposits made by associated entities was not required to be adjusted in proportion to the borrower's interest in the entity.

Key features

The amendments will ensure that refunds of main income equalisation scheme deposits made by an associated entity of a borrower are not included in the income of the borrower, to the extent of the borrower's interest in the associated entity. However, any interest earned on those deposits that is refunded will be included in the adjusted net income of the borrower in the same proportion as the borrower's interest in the entity.

Similarly, adjustments to net income to reflect deposits by associated entities of a borrower are to be further adjusted so that they are proportional to the borrower's interest in the entity.

Amendments to schedule 3 of the Student Loan Scheme Act 2011, which sets out the required adjustments to net income, ensure that when a deposit has been made into, or a refund received from, a main income equalisation account by an associated entity of a borrower, the adjustments will affect the adjusted net income of the borrower only to the extent of the borrower's interest in that associated entity.

Replacement clause 7 of schedule 3 and new clause 7A will apply only to deposits into or refunds from main income equalisation accounts made by a borrower.

However, new clauses 8 and 11 will apply respectively when a borrower is a major shareholder in a close company or is the settlor of a trust. These clauses set out the calculations to be used to ensure that the adjustments to the borrower's net adjusted income accurately reflect the extent of the borrower's interest in the associated entities.

Example

Jasmine has a student loan. She is a major shareholder in a company which owns a farm, holding 80 percent of the shares.

Jasmine's company has net income of $88,000 and also received a refund of $50,000 plus interest of $2,000 from the company's main income equalisation scheme account on 15 August 2015. At the end of the tax year the company's taxable income will be $140,000 ($88,000 + $2,000 + $50,000).

However, when Jasmine goes to calculate her attributed company income, she will exclude the amount originally deposited into the main income equalisation scheme of $50,000 and apportion her share of income relative to her share-holding. She will enter net income of $72,000 ($88,000 + $2,000) × 80% on the IR215 form "Adjust your income".

Application date

The amendments came into force on 14 May 2016, being the day after the date of enactment.

FACILITATING ELECTRONIC COMMUNICATION

Sections 15, 169, 213 and 214 of the Student Loan Scheme Act 2011

The only two types of communication under the Student Loan Scheme Act 2011 which, by definition, were prevented from being made by electronic means, have been amended to allow electronic communication, such as by email. Both are notifications to the Ministry of Social Development – one to notify a borrower's wish to cancel a loan contract, and the other to require determination of an objection relating to their loan.

Background

Before January 2012, cancellation of loan contracts by electronic means was acceptable in accordance with the terms of the contract. However, a subsequent amendment to the Student Loan Scheme Act imposed a requirement of cancellation by formal notification, which, in accordance with the definition of that term, excludes notification by electronic means.

Following advice of their entitlement to a student loan, a student has seven days in which to give notice of their intention to cancel the contract. It is therefore more efficient, and in accordance with the Ministry of Social Development's current procedures, to accept cancellation by electronic means.

In addition, the 2012 change was one of a number intended to ensure consistency with the spirit and intent of the Credit Contracts and Consumer Finance Act 2003, even though that Act allows cancellation of contracts by giving written notice, including in electronic form.

Similarly, if a borrower required the chief executive (of the Ministry of Social Development) to determine an objection about details of a loan advance, they were required to do so by formal notification, excluding electronic means, even though other types of appeals under the Social Security Act are allowed to be made by electronic means.

Key features

The amendment to section 15 will change the requirement to cancel a loan contract from "formally notify" to "notify in writing". The latter term is already defined for the purposes of the Student Loan Scheme Act 2011, and allows communication by electronic means, subject to compliance with relevant provisions of the Electronic Transactions Act 2002.

A similar amendment to section 169 will allow a borrower to notify the chief executive of the Ministry of Social Development in writing that they wish the chief executive to determine an objection to details of their loan advance.

As a result of these two amendments, the term "formally notify", as defined in section 213, no longer has application in the Student Loan Scheme Act 2011 and section 213 has been consequentially repealed.

A further consequential amendment to section 214 removes the reference to section 213.

Application date

The amendment to section 15 is treated as coming into force on 1 January 2012, to ensure that borrowers who have already had their cancellations accepted by electronic means are not inadvertently in breach of the law.

The amendments to sections 169, 213 and 214 came into force on 14 May 2016, being the day after the date of enactment.

REPAYMENT OBLIGATIONS OF OVERSEAS-BASED BORROWERS

Schedule 6 of the Student Loan Scheme Act 2011

A transitional provision ensures that the loan balance thresholds for calculating the repayment obligations of overseas-based borrowers apply only for tax years beginning on 1 April 2014 and later.

Background

New repayment thresholds for overseas-based borrowers introduced in the Student Loan Scheme Amendment Act 2014 were intended to apply for the tax years commencing on and after 1 April 2014, but that was not made explicit in the legislation. The effect was that the new rules could be applied to the assessment of repayment obligations for tax years before 1 April 2014, when the actual assessment is carried out after 1 April 2014.

Key features

A "savings provision" – clause 18, part 3 of schedule 6 of the Student Loan Scheme Act 2011 – ensures that previous amendments to repayment obligations of overseas-based borrowers do not apply to tax years that commenced before 1 April 2014. Instead, the previous repayment obligations apply to those years.

Application date

The amendment applies to tax years starting on 1 April 2014.

REMEDIAL MATTERS

LAND PROVISIONS

Exercising an option

Section CB 15B of the Income Tax Act 2007

An amendment has been made to section CB 15B, the provision that determines the date on which land is acquired for the purposes of the land provisions (except the bright-line test). The amendment clarifies the date of acquisition for when land is acquired through the exercise of an option.

Background

The general rule in section CB 15B is that land is acquired when a person first acquires an interest in the land. Previously, in the case of land acquired through an option, it was unclear how the general rule applied.

Key features

The amendment makes it clear when land is acquired through the exercise of an option, the first interest in that land is acquired at the time the option is exercised.

Application date

The amendment came into force on the date of enactment, being 13 May 2016.

SETTLEMENT OF RELATIONSHIP PROPERTY

Section FB 3A of the Income Tax Act 2007

An amendment has been made to section FB 3A(3), the subsection that deals with the date of acquisition of land when land is acquired on a settlement of relationship property. The amendment is to correct a drafting omission. The references in section FB 3A(3) have been extended to refer to sections CB 6A(2)-(4) because these provisions also deal with acquisition dates that are relevant for section FB 3A purposes.

Application date

The amendment came into force on 1 October 2015 – the same date the bright-line legislation took effect.

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.

DETERMINATION FDR 2016/03 – 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)

Class A shares in Man AHL Pure Momentum Limited ("AHL Limited"), to which this determination applies, are attributing interests in a foreign investment fund ("FIF") for New Zealand resident investors.

The investments held by AHL Limited may consist predominantly of financial arrangements. In addition, some resident investors may hedge their attributing interests in AHL Limited back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent the investors from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

AHL Limited is a leveraged product and "the Investment Manager will seek to provide an initial target exposure of 300% of the Net Asset Value" and "the investment exposure may be increased or decreased from time to time". Leverage may arise from the use of derivatives and/or borrowing by the company or the underlying funds in which it invests.

Notwithstanding that AHL Limited may have assets predominantly comprising financial arrangements and the presence of the hedging arrangements, 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 resident investors to use the fair dividend rate method to calculate FIF income from its attributing interest in AHL Limited.

Scope of determination

This determination applies to Class A shares held by New Zealand resident investors in AHL Limited.

AHL Limited:

- is a Cayman Islands exempted company operating as an open-ended investment fund registered under the Companies Law of the Cayman Island (2013 Revision);
- issues shares that are not denominated in New Zealand dollars;
- employs a systematic momentum strategy through investment in derivative instruments and equity or debt securities (using a high degree of leverage), to provide exposure to a range of global equity, bond, currency and commodity markets; and
- may also hold exchange traded funds and other funds.

New Zealand resident investors may hedge their attributing interests in AHL Limited back to New Zealand dollars.

It is a condition of this determination that the investment in AHL Limited is not part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.

It is an additional condition of this determination that the FDR method will apply unless the absolute value of AHL Limited's actual notional derivative exposure is 25% or less of its Net Asset Value for a continuous period of 45 days. Should this occur, the determination ceases to apply from the first day of the quarter immediately following the expiry of the 45 day period.

Interpretation

In this determination unless the context otherwise requires:

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

"Foreign investment fund" means foreign investment fund 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;

"AHL Limited" means Man AHL Pure Momentum Limited, which is a Cayman Island exempted company operating as an open-ended investment fund registered under the Companies Law of the Cayman Island (2013 Revision).

Determination

This determination applies to an attributing interest in a FIF, being a direct income interest in AHL Limited. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate FIF income from the 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 Class A shares in Man AHL Pure Momentum Limited unless that investor chooses that determination to apply for that income year.

Dated this 23rd day of May 2016.

John Trezise
Investigations Manager, Investigations & Advice
Inland Revenue

SPECIAL DETERMINATION S46: VALUATION OF SHARES ISSUED BY BANK ON CONVERSION OF NOTES

This Determination may be cited as Special Determination S46: Valuation of Shares Issued by Bank on Conversion of Notes.

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

1.1 This determination relates to a funding transaction involving the issue of Notes by the Bank to the New Zealand branch of its Australian parent company. The Notes will contain a conversion mechanism, in order to allow them to be recognised as Additional Tier 1 capital for the purposes of the Reserve Bank of New Zealand framework relating to the capital adequacy of banks.

1.2 The Arrangement is the subject of private ruling BR Prv 16/24 issued on 30 May 2016, and is fully described in that ruling.

1.3 Each Note is a "financial arrangement" (as defined in s EW 3) consisting of a debt instrument and a contingent share subscription.

2. Reference

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

3. Scope of determination

3.1 This determination applies to a funding transaction involving the issue of Notes by Bank to the New Zealand branch of its Australian parent pursuant to a Deed Poll. The Deed Poll will set out the steps that will occur upon Conversion.

3.2 If a Conversion occurs, the relevant number of Notes must be immediately and irrevocably converted on the relevant Conversion Date. In summary, the steps for the Conversion of the Notes will be as follows:

(a) The rights of the New Zealand branch of the Australian parent in relation to each Note to be converted will be immediately and irrevocably terminated and repaid by Bank for an amount equal to the face value of the Notes.

(b) The New Zealand branch of the Australian parent is taken to have irrevocably directed that any amount payable to it in accordance with paragraph (a) above will be applied by Bank by way of subscription for ordinary shares.

(c) Bank will allot and issue the specified Conversion Number of ordinary shares to the New Zealand branch of the Australian parent in consideration for the payment by the New Zealand branch of the Australian parent of the subscription amount referred to in paragraph (b) above.

3.3 This determination applies when shares are issued by Bank to the New Zealand branch of the Australian parent on Conversion to determine the value of the shares for the purposes of the financial arrangements rules.

4. Principle

4.1 The Notes are each a financial arrangement (as defined in s EW 3) consisting of a debt instrument and a contingent share subscription. The contingent share subscription is an "agreement for the sale and purchase of property and services" (as defined in s YA 1), as it is a conditional agreement to acquire property.

4.2 The contingent share subscription is not a "short-term agreement for sale and purchase" (as defined in s YA 1), as settlement is not required to occur within 93 days of being entered into. As such, it is not an excepted financial arrangement under s EW 5.

4.3 For the purposes of determining the consideration paid or payable under the financial arrangements rules, the value of the shares issued by Bank must be established under s EW 32. None of subs (2B) to (5) of s EW 32 apply to the share subscriptions.

4.4 Under s EW 32(6), the Commissioner is required to determine the value of the property. Both parties are required to use this amount.

5. Interpretation

In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
- **Bank** means the bank issuing the Notes.
- The New Zealand branch of the Australian parent means the parent company of the bank, acting through its New Zealand branch.
- **Conversion** and **Conversion Number** have the same meaning as described in private ruling BR Prv 16/24, issued on 30 May 2016.
- **Conversion Date** means a Trigger Event Conversion Date, Exchange Date or Change in Control Conversion Date as each of those terms are defined in private ruling BR Prv 16/24, issued on 30 May 2016, as relevant.

- **Notes** means the fully paid, convertible, subordinated, perpetual securities issued by Bank to the New Zealand branch of the Australian parent.

6. Method

6.1 The Arrangement does not involve the advancement or deferral of income or expenditure.

6.2 For the purposes of s EW 32(6) the value of the shares issued by Bank is equal to the amount the New Zealand branch of the Australian parent paid for those shares.

7. Example

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

Bank issues Notes having a face value of $100 to Holders. Following a Conversion Event, Notes having a face value of $100 are converted into ordinary shares in Bank. Bank immediately repays the face value of the Notes and applies the relevant amount on the New Zealand branch of the Australian parent's behalf to subscribe for ordinary shares in Bank. Bank issues the number of shares to the New Zealand branch of the Australian parent calculated in accordance with the "Conversion Number" formula. The value of the aggregate shares issued, for the purposes of s EW 32, is $100.

This Determination is signed by me on the 30th day of May 2016.

Fiona Heiford
Manager, Taxpayer Rulings

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 16/01: INCOME TAX – COMPUTER SOFTWARE ACQUIRED FOR USE IN A TAXPAYER'S BUSINESS

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this Interpretation Statement.

Scope of this statement

1. This statement covers the income tax treatment of software for taxpayers who purchase, lease, licence, develop, or commission software for use in a business carried on for the purposes of deriving assessable or excluded income. The statement expressly refers only to taxpayers that are carrying on a business. However, except where otherwise stated, the principles in this statement also apply to taxpayers who incur expenditure on software in deriving assessable or excluded income (otherwise than in the course of carrying on a business).

2. This statement does not consider:
   - the income tax treatment of software for taxpayers that develop software for third parties – e.g to earn income from the sale or licence of the software (software developers);
   - the treatment of software funded by a government grant and, in particular, the application of s DF 1; or
   - the application of any specific research and development provisions other than s DB 34; or
   - any potential withholding tax obligations that a taxpayer may have – for example, for royalties or interest paid to a non-resident software supplier, or for services provided by a non-resident contractor. These issues are covered in IG0007 "Non-resident software suppliers' payments derived from New Zealand – Income tax treatment" *Tax Information Bulletin* Vol 15, No 11 (November 2003) (it is noted that this statement is due to be reviewed).

Summary

3. The following is a brief summary of the main income tax implications of acquiring or developing software for use in a business. Further details are set out in the analysis section below.

Software purchases

- Software purchased will generally be a capital asset that must be depreciated at 50% diminishing value or 40% straight-line.
- An immediate write-off for software costing less than $500 will be allowed where the conditions in s EE 38 are satisfied.
- Maintenance costs may be deducted when incurred.
- Upgrade costs must be capitalised and depreciated.

Periodic payments for the right to use or access software

- Periodic payments for the right to use or access software (often online software) are generally deductible when incurred.

Software developed in-house for use in business

- Expenditure incurred in undertaking feasibility studies to determine whether to develop software will generally be deductible.
- Once a decision has been made to proceed with the development, any expenditure incurred beyond that point should be capitalised until the software is either completed or abandoned.
- If the software is completed for use in the taxpayer's business, the cost of the software can be depreciated at 50% diminishing value or 40% straight-line.
- If software is abandoned before it becomes depreciable property, a deduction may be allowed for the expenditure incurred in developing the software.

- Expenditure incurred in maintaining software once it has been completed will generally be deductible when incurred.
- Upgrade costs must be capitalised and depreciated.

Commissioned software

- Expenditure on software commissioned by a taxpayer for use in its business should be capitalised until the software is complete. The costs can then be depreciated over the life of the item.
- If the software is abandoned before it becomes depreciable property, a deduction may be allowed for the expenditure incurred in developing the software.

Lease of software under finance lease

- Software leased under a finance lease is treated as a sale of software by the lessor to the lessee. Also, the lessor is treated as giving a loan to the lessee for the software and the lessee is treated as using the loan to buy the software.
- The Act then applies to the arrangement as recharacterised.
- The financial arrangements rules apply to the loan.
- The depreciation rules apply as if the lessee owned the software.
- The treatment at the end of the finance lease depends on who acquires the rights to the software at the end of the lease term.

Introduction

4. In 1993, the Commissioner published a policy statement setting out the income tax treatment of computer software (see Appendix to *Tax Information Bulletin* Vol 4, No 10 (May 1993)). Since then, there have been a number of legislative changes that mean that parts of that item are now out of date.
5. This item updates and replaces the 1993 item except for the parts of that item that deal with taxpayers carrying on a software development business.

Analysis

6. This statement covers the income tax treatment of software for taxpayers who:
   - purchase software for use in their business;
   - make periodic payments for the right to use software (other than under a finance lease) in their business;
   - develop software in-house for use in their business;
   - commission software development for use in their business; or
   - lease software under a finance lease for use in their business.
7. Each of these situations is considered below. As the depreciation provisions are relevant to four of the situations, a more general discussion on depreciation is included after the discussion of the specific scenarios.

Software purchases

8. When software is purchased (whether "off the shelf" or online), generally the purchase price will be paid for the right to use the software (in the form of a licence). A taxpayer who acquires software for use in a business gets an enduring benefit. The expenditure incurred is capital in nature and non-deductible, but the taxpayer can claim depreciation on the software over its life.
9. The cost of maintaining the software is deductible expenditure under s DA 1. The cost of upgrades must be capitalised and depreciated. The depreciation treatment is discussed in more detail below (from [35]).

Periodic payments for the right to use or access software

10. Where a taxpayer makes periodic payments for the right to use or access software (other than software leased under a finance lease), the payments will generally not give rise to a capital asset. This can occur, for example, where a taxpayer pays a periodic licence fee for the right to use software or where a taxpayer pays a subscription fee to access software online (also known as software as a service). The payments will be deductible under s DA 1 (subject to the general limitations in s DA 2). A deduction will be allowed in the income year that the expenditure is incurred, unless a specific timing provision applies.

Software developed in-house for use in business

11. A business (not including a software development business) may develop software in-house for use in its own business. Developing software in-house will generally create a capital asset. The tax treatment of the costs incurred in the software development will differ for different phases of the development. More detailed principles relating to the deductibility of expenditure incurred in developing or acquiring a capital asset are set out in the interpretation statement IS 08/02: "Deductibility of Feasibility Expenditure" (*Tax Information Bulletin* Vol 20, No. 6 (July 2008): 12). However, in summary, the following principles apply.

Expenditure determining whether the software is feasible

12. Expenditure incurred in undertaking feasibility studies to determine whether to develop a capital asset will generally be deductible under s DA 1(1) (assuming the asset is to be used in the taxpayer's income earning

process). In the context of software development, this means that expenditure incurred analysing the feasibility of developing a piece of software for use in a business would be deductible. That is, expenditure incurred principally for the purpose of placing a taxpayer in a position to make an informed decision about the development of some software will not generally be expenditure incurred in relation to that software.

Expenditure developing the software

13. Once a decision has been made to proceed with the development, any expenditure incurred beyond that point will relate to the software. From that point on, expenditure should be capitalised until the software is either completed or abandoned. This includes both direct costs and indirect costs. Direct costs include personnel costs directly attributable to the project, and depreciation costs on hardware dedicated to the project. Indirect costs are overhead costs that cannot be directly linked to a particular project. These may include general overhead costs (such as rates, rent, insurance, and energy costs), indirect labour costs, and indirect material costs (such as paper, and printer toner).
14. Direct costs should be relatively easy to calculate (for example personnel costs can be calculated by recording the direct hours spent by staff on a project).
15. Indirect costs (including utility costs, rental or ownership costs of property etc…) should be allocated using a method that gives a fair and reasonable result. A possible allocation method might be based on the proportion of direct person hours allocated to the project. Where accurate time recording is not undertaken, a functional analysis of what each employee working on the project does may be appropriate. However, a taxpayer can use another method if it can be shown that it is appropriate. For example, in some circumstances, a method based on the proportionate time and space used for the project may be appropriate.
16. If the software is completed for use in the taxpayer's business its cost can be depreciated (see from [35] below). To be depreciable, the software must be used or available for use. In the Commissioner's view, a piece of software will be available for use when it is capable of being used for the purpose that it was developed. This is likely to be after it has been tested to determine that it works as intended and when it is ready (or materially ready) to 'go live'.
17. For depreciation purposes, s EE 18B includes the amount of expenditure incurred in developing the software as part of the cost of the copyright in the software. The copyright in the software is the depreciable property, as it is listed in sch 14. If the software is developed as a series of modules that can be operated independently, each module can be depreciated as it is implemented. At that time it will be "depreciable property", and will be used or available for use in the taxpayer's business.
18. If the software is abandoned before there is an item of depreciable property, s DB 40B may allow a deduction (see from [28] below).

Research and development (R&D) expenditure

19. An alternative treatment may be available where the expenditure on software is "research" or "development" and is recognised as an expense for financial reporting purposes[1].
20. The main provision of the Act applicable to R&D expenditure is s DB 34. Section DB 34 allows a deduction for expenditure (other than expenditure excluded under s DB 34(6)) incurred on R&D by those persons who:
    - recognise the R&D expenditure as an expense for financial reporting purposes under either of two designated financial reporting standards (s DB 34(2));
    - recognise the R&D expenditure as an expense for financial reporting purposes because it is written off as an immaterial amount but, had it been material, would have been required to recognise it as an expense for financial reporting purposes under either of the two designated financial reporting standards (s DB 34(4)); or
    - incur R&D expenditure of $10,000 or less in an income year, have recognised it as an expense for financial reporting purposes (but not, necessarily, under either of the designated reporting standards) and have written the amount off as immaterial (s DB 34(5)).
21. "Research" and "development" are both defined in paragraph 8 of the New Zealand Equivalent to International Accounting Standard 38, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place.
22. Taxpayers who incur R&D expenditure (excluding interest) can claim the deduction in the income year the expenditure is incurred or they can choose to

[1] See *Tax Information Bulletin*, Vol 26, No 4 (May 2014) for a discussion of the relationship between the minimum financial reporting requirements for companies under the Tax Administration (Financial Statements) Order 2014 and the references to financial reporting standards in the Income Tax Act 2007.

allocate the expenditure to a later income year in accordance with s EJ 23. A deduction can only be made in a later income year if there is income that arises as a result of the R&D expenditure in that year (R&D income). A taxpayer who is eligible for a deduction under s DB 34 has the option of not taking the deduction. They have the option of returning their income and expenditure on the basis that the section does not apply (s DB 34(8)).

23. If applied, the R&D rules override the capital limitation but the general permission and other general limitations still apply (s DB 34(10)).

Post-development maintenance and upgrades

24. Expenditure incurred in maintaining software once it has been completed will generally be revenue in nature and deductible under s DA 1. This would include expenditure such as fixing programming bugs, providing help desk facilities and making minor changes to the software - that is, routine changes that do not materially increase the capacity or performance of the software.

25. Expenditure on upgrades (or improvements) to the software will be capital in nature. A change will be an upgrade when it adds new features to the software, or increases its capacity, performance or life. The cost of upgrades must be capitalised and depreciated.

Other post-development expenditure

26. The capital cost of an item includes any expenditure on installation and getting the item ready for using to earn income (see *BP Refinery (Kwinana) Ltd v FCT* (1960) 12 ATD 204 and IS 10/06 "Deductibility of business relocation costs" *Tax Information Bulletin* Vol 22, No 8 (September 2010)). Therefore, any expenditure on installing or integrating the software with the taxpayer's system will be capital.

27. Other post-development expenditure will usually be deductible under s DA 1. These costs could include, for example, producing instruction manuals and staff training.

Unsuccessful software

28. Section DB 40B overrides the capital limitation and provides a deduction for expenditure incurred on unsuccessful software development (to the extent that a deduction has not already been allowed). It only applies where the software was being developed for use in the taxpayer's business. The development of the software must be abandoned before the copyright in the software becomes "depreciable property". Section DB 40B also requires that the copyright in the software would have been depreciable property if the development had been completed.

29. If the requirements of s DB 40B are met, a deduction (for both the current year expenditure and the expenditure capitalised in earlier income years) is allowed in the income year in which the development of the software is abandoned.

Sale of copy of developed software

30. A taxpayer who has developed software for use in their business (and capitalised and depreciated the development costs) may also subsequently sell a copy to a third party. For example, a manufacturing business may sell a copy of the stock control software used in its business to another manufacturing business. The proceeds of the sale will be assessable income.

31. The taxpayer should continue to depreciate the development costs. If there are costs associated with producing the second copy of the software (for example, the costs of printing manuals and training materials), these will be deductible.

Commissioned software

32. Commissioned software is treated the same as software developed in-house (see from [11] above). Software commissioned by taxpayers for use in their business will be a capital asset. The costs must be capitalised until the software is complete. The costs can then be depreciated over the life of the item. The depreciation treatment is discussed in more detail below (from [35]).

33. If the development is abandoned before the software is completed, s DB 40B may apply to allow a deduction for the costs incurred. See [28] and [29] above. The treatment of post-development expenditure is the same as for software developed in-house (see from [24] above).

34. Where the expenditure on the software is "research" or "development" expenditure, s DB 34 may apply to allow an earlier deduction. See from [19] above.

Depreciation

35. Under s EE 6, for property to be depreciable, it must be property that, in normal circumstances, might reasonably be expected to decline in value while it is used (or available for use) in a business. For intangible property to be depreciable, it must also be listed in sch 14. Schedule 14 includes the copyright in software, the right to use the copyright in software, and the right to use software (such as under a licence). The property must also not be subject to any of the

exclusions in s EE 7 (for example, low value property that has been dealt with under s EE 38).

36. The depreciation rate for the copyright in software, the right to use the copyright in software, and the right to use software is 50% diminishing value or 40% straight-line. An immediate write-off for software costing less than $500 will be allowed where the conditions in s EE 38 are satisfied.

37. If a taxpayer has a number of low value items of depreciable property (each item being below the maximum pooling value in s EE 65 (generally $5,000)), the taxpayer may be able to use the pool method to depreciate the group of items. The requirements for using the pool method are set out in ss EE 20 to EE 24, EE 65 and EE 66.

38. The cost of software upgrades (improvements) must be capitalised and depreciated (at 50% diminishing value or 40% straight-line). Section EE 37 sets out how improvements should be depreciated. It provides for improvements to be treated as separate items of depreciable property from the item being improved.

39. If a taxpayer believes that their particular software should have a higher or lower rate than that set by the Commissioner, the taxpayer can apply to the Commissioner for a special rate under s 91AAG of the Tax Administration Act 1994. The requirements for an application, including the associated fees, are set out in the Income Tax (Depreciation Determination) Regulations 1993. For a special rate to be given, a taxpayer needs to demonstrate that the economic life of their software is either greater or less (as the case may be) than four years (which is the economic life on which the 50% diminishing value and 40% straight line rates are based). The consequences of obtaining a special rate are set out in s EE 36.

When software disposed of or no longer used

40. Sections EE 48 to EE 52 apply where a person receives consideration from the disposal of an item of depreciable property in the circumstances described in ss EE 44 to EE 47. They set out how to calculate an amount of depreciation recovery income or depreciation loss and may give rise to an amount of income or deduction. Relevantly, however, ss EE 48 to EE 52 do not apply when a person disposes of an item of intangible property as part of an arrangement to replace it with an item of the same kind.

41. Section EE 39 applies when a person has an item of depreciable property (other than property that had been depreciated using the pool method) that is no longer used. Section EE 39(4) provides that a person will have an amount of depreciation loss if:

- they no longer use the item in their business, and
- neither they nor an associated person intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income, and
- the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

42. When the above criteria are met, a taxpayer will have an amount of depreciation loss equal to the item's adjusted tax value at the start of the income year. The taxpayer will be entitled to a deduction for this amount under s DA 1. The item's adjusted tax value at the end of the income year will then be zero.

43. Sometimes, taxpayers may not wish to or may not be able to dispose of their software when it is no longer useful. Also, sometimes, rather than being disposed of, old software may be incorporated into a new version. The Commissioner's view is that, where the software is still capable of being used by the taxpayer, it can continue to be depreciated. Where the software is incorporated into a new piece of software, the Commissioner's view is that the software is still used or available for use and can continue to be depreciated.

Lease of software under finance lease

Meaning of "finance lease"

44. "Finance lease" is defined in s YA 1:

> **finance lease** means a lease of a personal property lease asset entered into by a person on or after 20 May 1999 that—
>
> (a) when the person enters the lease, involves or is part of an arrangement that involves—
>
> (i) the transfer of the ownership of the asset to the lessee or an associate of the lessee during or at the end of the term of the lease:
>
> (ii) the lessee or an associate of the lessee having the option of acquiring the asset for an amount that is likely to be substantially lower than the asset's market value on the date of acquisition:
>
> (iii) a right of an associate of the lessee to acquire the asset, or a right of the lessor to require an associate of the lessee to acquire the asset, during the term of the lease under an arrangement that does not entitle the associate to receive all of the personal property lease payments that may fall due after the acquisition:
>
> (b) when the person enters the lease or from a later time, involves a term of the lease that is more than 75% of the asset's estimated useful life as defined in section EE 63 (Meaning of estimated useful life):

(c) the person enters on or after 20 June 2007 and is, or is part of, an arrangement that, when the person enters the lease or when a change in the terms of the arrangement changes the allocation or size of the risks and rewards incidental to ownership of the lease asset,—

(i) involves the use of the asset outside New Zealand for all or most of the term of the lease; and

(ii) involves income of any person who is not the lessor, arising from the use of the asset by any person, that is exempt income, or excluded income, or non-residents' foreign sourced income; and

(iii) is a finance lease under NZIAS 17 for the lessor, or for a company that is in the same group of companies as the lessor and derives assessable income from the arrangement, or is an arrangement under which persons who do not include the lessor bear substantially all the risks and rewards incidental to ownership of the lease asset, determined as at the time the person enters the lease and taking into account later changes to the arrangement

45. The term "lease" is defined in s YA 1. Relevantly, for the purposes of the finance lease provisions, it treats two or more consecutive or successive leases of the same property (to the lessee or an associate) as a single lease.

46. Therefore, a lease will be a "finance lease" if it meets the criteria in one or more of paras (a), (b), or (c) of the definition.

47. Broadly, para (a) captures arrangements where ownership of the lease asset is transferred to a lessee (or an associate), or the lessee (or an associate) has an option to acquire the lease asset for substantially below market value. It also applies where the arrangement involves a right of an associate of the lessee to acquire the asset, or a right of the lessor to require an associate of the lessee to acquire the asset, during the term of the lease where the associate is not entitled to receive all of the lease payments after the acquisition.

48. Paragraph (b) applies where, either when the person enters the lease, or at a later date, the term of the lease is greater than 75% of the asset's estimated useful life.

49. Paragraph (c) will apply less commonly. In particular, it only applies where the leased asset is used outside New Zealand for all or most of the term of the lease, and involves exempt income, excluded income or non-residents' foreign sourced income arising from the use of the asset (other than by the lessor).

Implications of having a finance lease

50. When personal property is leased under a finance lease, the lease is treated as a sale of the lease asset by the lessor to the lessee on the date on which the term of the lease starts (s FA 6). Also, the lessor is treated as giving a loan to the lessee for the lease asset and the lessee is treated as using the loan to buy the lease asset. The Act then applies to the arrangement as recharacterised.

51. As the lease is recharacterised as a sale with an associated loan, the financial arrangements rules in subpart EW apply. For the lessor, the amount of the loan is determined under s EW 32 (s FA 7(1)). For the lessee, the amount of the loan is determined under ss EW 32 and EW 33 (s FA 7(2)).

52. The depreciation rules in subpart EE also apply. The lessee is treated as the owner of the software (s FA 8(2)) and the lessor is not treated as the owner of the software. The depreciation treatment is discussed in more detail above (from [35]).

53. Where an operating lease becomes a finance lease, the lessor and lessee must both adjust their income and expenditure. Section FA 11 sets out the requirements and formula for the adjustments.

Treatment when the lease ends

54. Section FA 9 sets out the treatment at the end of a finance lease where the lessee acquires the asset. When a lessee acquires the software by the end of the lease term, the acquisition is treated as the same sale that was previously treated as occurring under s FA 6. Where the lessee (or an associate) acquires the software and later disposes of it for more than the consideration they paid, the excess is income of the lessee under s CC 11 (unless it is income under another provision of the Act). The income must be returned in the income year in which the lessee (or associated person) disposes of the asset (s FA 9(3)(a)).

55. Section FA 10 sets out the treatment where the lessor is treated as acquiring the asset at the end of the lease (because the lessee has not acquired the lease asset by the end of the lease).

Examples

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

Example 1 – periodic payments for access to online software

57. United Chemists Ltd runs a chain of pharmacies. It uses online accounting software for financial reporting, invoicing, inventory management and payroll. United Chemists pays a subscription fee of $50 per month to access the software online. United Chemists wants to know whether this fee is deductible.

58. The fee is deductible under s DA 1.

Example 2 – unsuccessful software developed in-house for use in taxpayer's business

59. Sell To Me Ltd sells household goods online. It stores the goods in five large warehouses around New Zealand. In the 2014 income year Sell To Me Ltd decided to develop some new inventory management software. It employed a computer science student (Stanley) to undertake this work and purchased a computer that was used 50% by Stanley and 50% for other business purposes.

60. Stanley works on the software for three months during a holiday break from university. In total, Sell To Me Ltd incurred expenditure of $50,000 developing the software. This amount includes Stanley's wages, 50% of the depreciation on the computer for the relevant period, and rent and utilities for the office space leased for Stanley to work in. Stanley was never able to make the software function correctly. After three months, he left Sell To Me Ltd and returned to university. In the 2015 income year, Sell To Me Ltd discovers that it is going to cost a further $50,000 to complete the software. It decides to abandon development of the software and purchase an off the shelf inventory management system instead. Sell To Me Ltd wants to know how the software development costs should be treated for income tax purposes.

61. In the 2014 income year, a decision has already been made to proceed with the software development. Therefore, the expenditure incurred is capital and not deductible in the 2014 income year. The expenditure is also not depreciable in the 2014 income year as there is no completed asset available to be used in the taxpayer's business. In the 2015 income year, Sell To Me Ltd decides to abandon the software. It is entitled to a deduction for all of the expenditure incurred in the development of the unsuccessful software.

Example 3 – software commissioned for use in taxpayer's business

62. In the 2013 income year, Bank With Me Ltd contracts with XYZ Software Limited to design and implement a new app to allow its customers to undertake banking transactions from their smart phones. Bank With Me will receive all rights to the app once it is complete. The software is completed in the 2015 income year. After completion, XYZ runs a two day training course for Bank With Me's staff to teach them how to use the new software. XYZ also provides ongoing maintenance services once the app is running. Bank With Me wants to know how to treat the payments that it makes to XYZ for income tax purposes.

63. The development costs incurred by Bank With Me on the app software must be capitalised until the 2015 income year when the app software is completed. At that time, it will be available for use in the taxpayer's business and the costs can be depreciated.

64. Once the app software is complete, any payments for maintenance services will be deductible when they are incurred.

65. The costs of training staff to use the app once it is complete are revenue in nature and are deductible when incurred.

Maintenance

66. A short time later, one of the major mobile phone software providers upgrades its operating system. Bank With Me's app will not run on the upgraded system so Bank With Me hires XYZ Software again to make the relatively minor modifications required so that the software will run on the new operating system. At the same time, XYZ Software also fixes a number of minor bugs. Bank With Me wants to know whether the costs of the changes should be treated as capital or revenue.

67. The changes to Bank With Me's app are revenue and can be deducted when incurred. As operating system software is upgraded relatively frequently, making modifications to software so that it can run on the upgraded system is more in the nature of maintenance rather than an upgrade. The changes do not add any new functionality as such. Rather they allow the app to continue to run consistently with its original specifications. The fact that a few minor bugs were fixed at the same time does not change this conclusion.

Example 3 (continued)

Upgrade

68. The following year, Bank With Me decides to make some modifications to the app to allow users to make payments directly to other app users via Bluetooth. Bank With Me again hires XYZ Software to make the changes.

69. The change adds a material new function to the software and, as such, is an upgrade and should be capitalised and depreciated in accordance with s EE 37.

Example 4 – allocation of indirect costs for in-house developer

70. XYZ Insurance Ltd has an in-house operation which develops software for use in the insurance company's business. In the last income year the software development operation worked on one major project and spent the rest of the time on maintenance work for existing software.

71. The in-house operation employs two staff for software development and maintenance work. Each staff member works 1,000 hours a year.

	Project Development work (hours)	Maintenance work (hours)	Total
Jack	800	200	1,000
Jill	600	400	1,000
Total	**1,400**	**600**	**2,000**

Indirect overhead costs allocated to software development operation for income year: $100,000
Allocation of indirect overhead to project:
Total hours worked = 2,000 hours
Proportion of hours worked for project = 1,400/2,000
= 0.7
Indirect overhead costs of project = $100,000 × 0.7
= $70,000

72. Therefore, besides the direct costs of the project, XYZ Insurance Ltd must capitalise an additional $70,000 of indirect overhead cost for the project. When the development is completed capitalised costs will be deductible under the depreciation regime.

Example 5 – software still undergoing testing

73. XYZ Accounting Ltd is a large national accounting firm. It commissions Brittany to develop a new document management system.

74. At the end of April, Brittany completes the initial development and the software is operational. During May and June the software undergoes extensive testing by two of XYZ Accounting's staff members. During this time a number of issues are identified that require further development. In July, Brittany completed the required changes. A final testing phase is carried out in August. On 1 September it is determined that the software is ready to go live. The actual rollout to all staff occurs on 1 October. A number of minor bugs are identified and Brittany fixes these on 1 November.

75. XYZ Accounting wants to know when it can start depreciating the software. The software was available for use in the taxpayer's business from 1 September and can be depreciated from this date. Prior to this the software was not available for use as it was still being tested and it had not been determined that it could be used as intended. It is not necessary for XYZ Accounting to wait until the software is actually rolled out for use by staff (as long as it is capable of being used). Nor does it matter that the software still contains some minor bugs.

References

Related rulings/statements
IG0007 "Non-resident software suppliers' payments derived from New Zealand – Income tax treatment" *Tax Information Bulletin* Vol 15, No 11 (November 2003)
"Income Tax Treatment of Computer Software" Appendix to *Tax Information Bulletin* Vol 4, No 10 (May 1993)
IS 08/02: "Deductibility of Feasibility Expenditure" *Tax Information Bulletin* Vol 20, No 6 (July 2008): 12
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Subject references
Abandoned software
Depreciation
Income Tax
Licence
Software
Unsuccessful software

Case references
BP Refinery (Kwinana) Ltd v FCT (1960) 12 ATD 204
Legislative references
Income Tax Act 2007: ss DA 1, DA 2, DB 40B, EE 6, EE 7, EE 18B, EE 36, EE 37, EE 38, EE 39, EE 44 – 47, EE 48 – 52, EE 65, EE 66, subpart FA, sch 14
Tax Administration Act 1994: s 91AAG

APPENDIX – LEGISLATION

1. Sections DA 1 and DA 2 state:

DA 1 General Permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

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

Avoidance arrangements

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

DA 2 General limitations

Capital limitation

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

…

Relationship of general limitations to general permission

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

2. Section DB 34 states:

DB 34 Research or development

Deduction

(1) A person is allowed a deduction for expenditure they incur on research or development. This subsection applies only to a person described in any of subsections (2) to (5) and does not apply to the expenditure described in subsection (6).

Person recognising expenditure as expense

(2) Subsection (1) applies to a person who recognises the expenditure as an expense for financial reporting purposes-

(a) under paragraph 5.1 or 5.2 of the old reporting standard or because paragraph 5.4 of that standard applies; or

(b) under paragraph 68(a) of the new reporting standard applying, for the purposes of that paragraph, paragraphs 54 to 67 of that standard.

Expenditure on derecognised non-depreciable assets

(3) Subsection (1) applies to a person who—

(a) incurs expenditure, on the development of an intangible asset that is not depreciable intangible property,—

(i) on or after 7 November 2013; and

(ii) before the intangible asset is derecognised or written off by the person as described in paragraph (b); and

(b) derecognises or writes off the intangible asset for financial reporting purposes under—

(i) paragraph 112(b) of the new reporting standard; or

(ii) paragraph 5.14 of the old reporting standard.

Person recognising expenditure otherwise

(4) Subsection (1) also applies to a person who—

(a) recognises the expenditure as an expense for financial reporting purposes because it is an amount written off as an immaterial amount for financial reporting purposes; and

(b) would be required, if the expenditure were material, to recognise it for financial reporting purposes-

(i) under paragraph 5.1 or 5.2 of the old reporting standard or because paragraph 5.4 of that standard applies; or

(ii) under paragraph 68(a) of the new reporting standard applying, for the purposes of that paragraph, paragraphs 54 to 67 of that standard.

Person with minor expenditure

(5) Subsection (1) also applies to a person who—

(a) incurs expenditure of $10,000 or less, in total, on research and development in an income year; and

(b) has written off the expenditure as an immaterial amount for financial reporting purposes; and

(c) has recognised the expenditure as an expense for financial reporting purposes.

Exclusion

(6) Subsection (1) does not apply to expenditure that the person incurs on property to which all the following apply:

(a) the property is used in carrying out research or development; and

(b) it is not created from the research or development; and

(c) it is 1 of the following kinds:

(i) property for which the person is allowed a deduction for an amount of depreciation loss; or

(ii) property the cost of which is allowed as a deduction by way of amortisation under a provision of this Act outside subpart EE (Depreciation); or

(iii) land; or

(iv) intangible property, other than depreciable intangible property; or

(v) property that its owner chooses, under section EE 8 (Election that property not be depreciable) to treat as not depreciable.

Choice for allocation of deduction

(7) A person who is allowed a deduction under this section for expenditure that is not interest and is described in subsection (2), (4), or (5) may choose to allocate all or part of the deduction—

(a) to an income year after the income year in which the person incurs the expenditure; and

(b) in the way required by section EJ 23 (Allocation of deductions for research, development, and resulting market development).

Allocation of deduction for derecognised non-depreciable assets

(7B) A person who is allowed a deduction as provided by subsection (3) must allocate the deduction to the income year in which the relevant intangible asset is derecognised or written off by the person for financial reporting purposes under—

(a) paragraph 112(b) of the new reporting standard; or

(b) paragraph 5.14 of the old reporting standard.

Section need not be applied

(8) A person may return income and expenditure in their return of income on the basis that this section does not apply to expenditure incurred on research or development in the income year to which the return relates.

Relationship with section EA 2

(9) If expenditure to which this section applies is incurred in devising an invention that is patented, the expenditure is not treated as part of the cost of revenue account property for the purposes of section EA 2 (Other revenue account property).

Link with subpart DA

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

3. Section DB 35 defines the following terms:

development is defined in paragraph 8 of the new reporting standard

new reporting standard means the New Zealand Equivalent to International Accounting Standard 38, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place

old reporting standard means Financial Reporting Standard No 13 1995 (Accounting for Research and Development Activities) being the standard approved under the Financial Reporting Act 1993, or an equivalent standard issued in its place, that applies in the tax year in which the expenditure is incurred

research is defined in paragraph 8 of the new reporting standard.

4. Section DB 40B states:

DB 40B Expenditure in unsuccessful development of software

When this section applies

(1) This section applies when a person incurs expenditure in the development of software for use in the person's business if—

(a) the development of the software is abandoned when the software is not depreciable property of the person; and

(b) the software would have been depreciable property of the person if the development had been completed.

Deduction

(2) The person is allowed a deduction for expenditure incurred in the development of the software to the extent to which no deduction has been allowed for the expenditure under another provision of this Act or under another Act.

Timing of deduction

(3) The deduction is allocated to the income year in which the development of the software is abandoned.

Link with subpart DA

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

5. The relevant provisions from subpart EE state:

EE 6 What is depreciable property?

Description

(1) Depreciable property is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—

(a) in deriving assessable income; or

(b) in carrying on a business for the purpose of deriving assessable income.

Subsections (2) to (4) expand on this subsection.

Property: tangible

(2) An item of tangible property is depreciable property if—

(a) it is described by subsection (1); and

(b) it is not described by section EE 7.

Property: intangible

(3) An item of intangible property is depreciable property if—

(a) it is within the definition of depreciable intangible property; and

(b) it is described by subsection (1); and

(c) it is not described by section EE 7.

…

EE 7 What is not depreciable property?

The following property is not **depreciable property:**

(a) land other than depreciable intangible property, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1):

(ab) a lease of land with a perpetual right of renewal:

(b) trading stock:

(c) livestock to which subpart EC (Valuation of livestock)) applies:

(d) financial arrangements:

(e) excepted financial arrangements other than depreciable intangible property:

(f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:

(g) property that its owner chooses, under section EE 8, to treat as not depreciable:

(h) property that its owner chooses, under section EE 38, to deal with under that section:

(i) property for whose cost a person other than the property's owner is allowed a deduction:

(j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under a provision of an earlier Act, except for an asset to which section DU 6(4) (Depreciation) applies.

EE 18B Cost: some depreciable intangible property

For the purposes of section EE 16 and this subpart, the cost to a person for an item of depreciable intangible property or a plant variety rights application (the **amortising item**) includes an amount of expenditure incurred by the person for an item of intangible property (the **underlying item**) if—

(a) the underlying item gives rise to, supports, or is an item in which the person holds, the amortising item; and

(b) the amount of expenditure is incurred by the person on or after 7 November 2013, if the amortising item is 1 of—

(i) a patent or a patent application with a complete specification lodged on or after 1 April 2005:

(ii) plant variety rights:

(iii) a plant variety rights application:

(iv) a design registration:

(v) a design registration application:

(vi) industrial artistic copyright; and

(c) the person is denied a deduction for the expenditure under a provision outside this subpart.

EE 36 Using economic rate or provisional rate instead of special rate

Allowed to use economic or provisional rate

(1) A person may depreciate an item to which a special rate applies by applying, instead, the economic rate applicable to the item or a provisional rate applicable to the item. This subsection is overridden by subsection (2)

Not allowed to use economic or provisional rate

(2) The person must not depreciate the item by applying the economic rate or the provisional rate, if—

(a) a special rate applies to the item; and

(b) the special rate is higher than the economic rate; and

(c) the person applies the special rate to the item for an income year; and

(d) in a later income year, the item's market value declines at a rate equal to or greater than the special rate; and

(e) it is a reasonable conclusion from all the circumstances of the case that the person's purpose, or 1 of the person's purposes, in wanting to change from the special rate to the economic rate or the provisional rate for the later income year is to enable the person to defer the deduction that the person is allowed for the amount of depreciation loss for the item's decline in value.

EE 37 Improvements

When this section applies

(1) This section applies when a person makes an improvement to an item of depreciable property.

Income year in which improvement made

(2) In the income year in which the person makes the improvement, the provisions of this subpart apply to the improvement, as if it were a separate item of depreciable property, in the period that—

(a) starts at the start of the month in which the person first uses the improvement or has it available for use; and

(b) ends at the end of the income year.

Following income years

(3) For income years following the income year in which the person makes the improvement,—

(a) a person who uses the diminishing value method or the straight-line method for the item that was improved may choose to apply subsection (4) or (5), if paragraph (ab) does not apply:

(ab) a person who uses the diminishing value method or the straight-line method for the item that was improved must use subsection (3B) if—

(i) treating the improvement as an item, section EE 31(2A) does not apply, but section EE 31(3A) does apply; and

(ii) the item that was improved is a grandparented structure, or is not a building, is not a used import car, is not an international aircraft, or has not been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it:

(b) a person who uses the pool method for the item that was improved must apply subsections (6) and (7).

Improvement compulsorily treated as separate item

(3B) For the purposes of subsection (3)(ab), a person must treat the improvement as a separate item of depreciable property.

Improvement treated as separate item

(4) For the purposes of subsection (3)(a), a person may choose to treat the improvement as a separate item of depreciable property.

Improvement treated as part of item

(5) For the purposes of subsection (3)(a), a person may choose to treat the improvement as part of the item of depreciable property that was improved. They must do 1 of the following for the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use:

(a) if they use the diminishing value method for the item, add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year:

(b) if they use the straight-line method for the item,—

(i) add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year; and

(ii) add the improvement's cost to the item's cost.

Pool method

(6) For the purposes of subsection (3)(b), a person who uses the pool method for the item that was improved must treat the improvement as a separate item of depreciable property. If its cost is equal to or less than its maximum pooling value, they must include it in a pool in the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use.

Adjustment of pool's value

(7) When an improvement is included in a pool under subsection (6),—

(a) the pool's adjusted tax value is increased by the improvement's adjusted tax value on the date it is included in the pool; and

(b) the improvement's adjusted tax value at the end of the previous income year is included in **starting adjusted tax value** in section EE 21(5).

EE 39 Items no longer used

When this section applies

(1) This section applies when a person in an income year has an item of depreciable property that—

(a) is no longer used or, because the geothermal energy proving period has ended, becomes unavailable for use under section EE 6(4); and

(b) is not a building, unless the item meets the requirements of subsection (2); and

(c) has not been depreciated using the pool method.

…

Amount of depreciation loss under this section

(3) The person has an amount of depreciation loss under this section and under no other provision of this subpart.

Circumstances

(4) The person has an amount of depreciation loss if—

(a) they no longer use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(b) neither they nor a person associated with them intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

Amount

(5) The amount of depreciation loss is the item's adjusted tax value at the start of the income year.

Adjusted tax value at end of year

(6) The item's adjusted tax value at the end of the income year is zero.

EE 44 Application of sections EE 48 to EE 52

When sections apply

(1) Sections EE 48 to EE 52 apply when a person has consideration from the disposal of an item or from an event involving an item, if—

(a) the consideration is consideration of a kind described in section EE 45; and

(b) either—

(i) the item is an item of a kind described in section EE 46; or

(ii) the event is an event of a kind described in section EE 47.

Exclusions

(2) Sections EE 48 to EE 52 do not apply when—

(a) a person disposes of an item of intangible property as part of an arrangement to replace it with an item of the same kind:

(b) a person's patent application has concluded because a patent is granted to the person in relation to the application:

(c) a person's geothermal well becomes unavailable for use under section EE 6(4) because the geothermal energy proving period has ended:

(d) a person receives, for an item of property, an amount of insurance to which section EZ 23B (Property acquired after depreciable property affected by Canterbury earthquakes) applies.

EE 45 Consideration for purposes of section EE 44

General rule

(1) For the purposes of section EE 44, the **consideration** equals the amount that a person derives excluding any GST charged if the person is a registered person, as modified by subsections (3) to (11) minus the amount (the **disposal cost**) that they incur in deriving that amount, to the extent to which the disposal cost—

(a) is not allowed as a deduction to the person other than as a deduction for an amount of depreciation loss; and

(b) is not counted in "the amount that a person derives".

GST for disposal costs

(1B) All amounts deducted or deductible by the person under section 20(3) of the Goods and Services Tax Act 1985 in relation to the disposal cost described in subsection (1) are subtracted from the disposal costs under that subsection.

Consideration may be zero or negative

(2) For the purposes of section EE 44, the **consideration** may be zero or a negative amount.

Other than market value

(3) If the person has consideration that is not the item's market value, the amount that the person derives is the item's market value. Three qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement; and

(c) this subsection does not apply in a case described in any of subsections (5) to (10).

Relationship with subpart FC

(4) Subsection (3) does not apply to a disposal of property to which any of sections FC 3 and FC 4 (which relate to the distribution or transmission of property) applies.

Change of use or location of use

(5) The consideration that a person derives from the event described in section EE 47(2) is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement.

Loss or theft

(6) The amount that a person derives from the event described in section EE 47(3) is the amount of insurance, indemnity, or compensation they receive for the loss or theft (**amount A**). If the person is a registered person, amount A does not include the amount, if any, of GST charged on amount A to the extent to which amount A is treated as being consideration received for a supply of services by the registered person under section 5(13) of the Goods and Services Tax Act 1985.

…

Repossession

(9) The amount that a person derives from the event described in section EE 47(5) is the item's cost minus the net amount paid. Two qualifications are—

(a) if the person is a registered person, the "amount that a person derives" does not include any GST charged on a taxable supply they make:

(b) "net amount paid" means the amount paid by the buyer to the seller for the item under the contract minus any amount refunded by the seller to the buyer.

Other items

(10) The amount that a person derives from the disposal of an item along with any other item, or from the occurrence of an event involving an item that also involves other items, is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement.

Item leaving New Zealand permanently

(11) The amount that a person derives from the event referred to in section EE 47(10) is described in section EZ 21(1) (Sections EE 45 and EE 47: permanent removal: allowance before 1 April 1995).

EE 46 Items for purposes of section EE 44

Items to which sections EE 48 to EE 52 apply

(1) For the purposes of section EE 44, an item of property to which sections EE 48 to EE 52 apply is an item of depreciable property that a person owns, including—

(a) an item for which the person has been allowed a deduction for an amount of depreciation loss they have had under section EE 33; and

(b) an item to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies.

Exclusions

(2) Sections EE 48 to EE 52 do not apply to—

(a) an item of property that, on the date on which the disposal or the event occurs, is accounted for in a pool; or

(b) an item of petroleum-related depreciable property; or

(c) an item of intangible property that is excluded depreciable property, other than software; or

(d) a land improvement that is excluded depreciable property of a kind for which no deduction for depreciation was allowed under section 108 of the Income Tax Act 1976.

EE 47 Events for purposes of section EE 44

Events to which sections EE 48 to EE 52 apply

(1) For the purposes of section EE 44, this section describes the events to which sections EE 48 to EE 52 apply.

Change of use or location of use

(2) The first event is the change of use, or change of location of use, of an item of property, as a result of which a person is denied a deduction for an amount of depreciation loss for the item for the next income year. The event is treated as occurring on the first day of the next income year, and includes a change in use of an item for the purposes of the definition of commercial fit-out and a change in the status of a building related to an item for the purposes of that definition.

Loss or theft

(3) The second event is the loss or theft of an item of property, if the item is not recovered in the income year in which the loss or theft occurs.

Irreparable damage or damage rendering building or grandparented structure useless

(4) The third event is—

(a) the irreparable damage of an item of property that is not a building or grandparented structure; or

(b) the damage of an item of property that is a building or grandparented structure, or of the neighbourhood of the building or grandparented structure, causing the building or grandparented structure to be—

(i) useless for the purpose of deriving income; and

(ii) demolished or abandoned for later demolition.

Repossession

(5) The fourth event is the seller's repossession of an item of property to which section EE 3 applies because the buyer wholly or partly fails to pay the consideration. The event is treated as occurring on the date on which the item is repossessed.

Unused geothermal well brought into use

(6) The fifth event is, for a person's geothermal well that is unavailable for use under section EE 6(4) because the geothermal energy proving period has ended, is when the person starts to—

(a) use the well in deriving assessable income or carrying on a business for the purpose of deriving assessable income:

(b) have the well available for use in deriving assessable income or carrying on a business for the purpose of deriving assessable income.

Statutory acquisition

(7) The sixth event is the acquisition of an item of property by a person acting under statutory authority.

Cessation of ownership under section EE 4 or EE 5

(8) The seventh event is the cessation of ownership of a fixture or improvement—

(a) that a lessee is treated as having under section EE 4(2); or

(b) that a person is treated as having under section EE 5(3).

Cessation of rights in intangible property

(9) The eighth event is an occurrence that has the effect that the owner of an item of intangible property is no longer able, and will never be able, to exercise the rights that constitute or are part of the item.

Item leaving New Zealand permanently

(10) The ninth event is described in section EZ 21(2) (Sections EE 45 and EE 47: permanent removal: allowance before 1 April 1995).

EE 48 Effect of disposal or event

Amount of depreciation recovery income

(1) For the purposes of section EE 44, if the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is the amount of depreciation recovery income derived by the person:

(a) the amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and

(b) the amount given by subsections (1B) and (1C).

Amount for subsection (1)(b)

(1B) The amount for the purposes of subsection (1)(b) is given by the following formula:

item depreciation loss + CZ 11 item amount + DB 64 item amount.

Definition of items in formula

(1C) In the formula in subsection (1B),—

(a) **item depreciation loss** is the total of the amounts of depreciation loss for which the person has been allowed deductions for the item:

(b) **CZ 11 item amount** is the amount of any deduction allowed for the acquisition of the item, for the person, if the item is one to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies:

(c) **DB 64 item amount** is the amount of the capital contribution for the item, for the person, if the item is one to which section DB 64 (Capital contributions) applies.

Amount of depreciation loss

(2) For the purposes of section EE 44, if the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss that is the amount by which the consideration is less than the item's adjusted tax value on that date.

Income year of depreciation recovery income

(2B) The person derives the depreciation recovery income in the income year that is the earliest income year in which the consideration can be reasonably estimated.

When subsection (2) does not apply

(3) Subsection (2) does not apply if the item is a building unless—

(a) the building or grandparented structure has been rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or grandparented structure or of the neighbourhood of the building or grandparented structure; and

(b) [Repealed]

(c) the damage is caused—

(i) by a natural event not under the control of the person, an agent of the person, or an associated person; and

(ii) other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

EE 49 Amount of depreciation recovery income when item partly used for business

Item to which this section applies

(1) This section applies to an item of property that—

(a) is an item to which this section applies, as described in section EE 46; and

(b) is, at any time during the period the person owns it, dealt with in—

(i) subpart DE (Motor vehicle expenditure); or

(ii) any applicable paragraph in section EZ 11 (Amounts of depreciation recovery income and depreciation loss for part business use up to 2004–05 income year); or

(iii) section EE 50.

Depreciation recovery income

(2) If the consideration referred to in section EE 44 is less than or equal to the cost of the item to the person, the amount of depreciation recovery income that the person has is an amount calculated using the formula in subsection (3).

Formula

(3) The formula is—

(all deductions ÷ (base value − adjusted tax value)) × amount of depreciation recovery income

Definition of items in formula

(4) The items in the formula are defined in subsections (5) to (8).

All deductions

(5) **All deductions** is all amounts of depreciation loss for which the person has been allowed a deduction for the item in each of the income years in which the person has owned the item.

Base value

(6) **Base value** has the applicable one of the meanings in sections EE 57 to EE 59.

Adjusted tax value

(7) **Adjusted tax value** is the item's adjusted tax value on the date on which the disposal or the event occurs.

Amount of depreciation recovery income

(8) **Amount of depreciation recovery** income is the amount described in section EE 48(1).

EE 50 Amount of depreciation loss when item partly used to produce income

When subsection (2) applies

(1) Subsection (2) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property for an income year, other than an amount arising under section EE 48(2); and

(b) at a time during the income year, the item is partly used, or partly available for use, by the person—

(i) in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(ii) in a way that is subject to fringe benefit tax; and

(c) at the same time, the item is partly used, or is partly available for use, by the person for a use that falls outside both paragraph (b)(i) and (ii); and

(d) the item is not a motor vehicle to which subpart DE (Motor vehicle expenditure) applies.

Partial use: formula

(2) The deduction the person is allowed for the amount of depreciation loss must not be more than the amount calculated using the formula—

depreciation loss × qualifying use of days ÷ all days

Definition of items in formula

(3) In the formula in subsection (2),—

(a) **depreciation loss** is the amount of depreciation loss for the income year:

(b) **qualifying use days** is the number of days in the income year on which the person owns the item and uses it, or has it available for use, for a use that falls within subsection (1)(b)(i) or (ii):

(c) **all days** is the number of days in the income year on which the person owns the item and uses it or has it available for use.

Other units of measurement

(4) A unit of measurement other than days, whether relating to time, distance, or anything else, is to be used in the formula if it achieves a more appropriate apportionment.

When subsection (6) applies

(5) Subsection (6) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property arising under section EE 48(2); and

(b) the item was, at any time during the period the person owned it, dealt with in—

(i) subsection (2); or

(ii) any applicable paragraph in section EZ 11 (Amounts of depreciation recovery income and depreciation loss for part business use up to 2004–05 income year); and

(d) the item is not a motor vehicle to which subpart DE applies.

Deduction for depreciation loss: formula

(6) The deduction the person is allowed for the amount of depreciation loss is calculated using the formula—

disposal depreciation loss × all deductions ÷ (base value − adjusted tax value at date)

Definition of items in formula

(7) In the formula in subsection (6),—

(a) **disposal depreciation loss** is the amount resulting from a calculation made for the item under section EE 48(2):

(b) **all deductions** is all amounts of depreciation loss relating to the item for which the person has been allowed a deduction in each of the income years in which the person has owned the item:

(c) **base value** has whichever is applicable of the meanings in sections EE 57 to EE 59:

(d) **adjusted tax value at date** is the item's adjusted tax value on the date on which the disposal or event occurs.

When subsection (9) applies

(8) Subsection (9) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property for an income year arising under section EE 48(2); and

(b) in the income year in which the amount of depreciation loss arises, the person starts to use the item, or have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) at a time during the income year, the item is partly used, or partly available for use, by the person—

(i) in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(ii) in a way that is subject to fringe benefit tax; and

(d) the item is not a motor vehicle to which subpart DE (Motor vehicle expenditure) applies.

Partial use: formula

(9) The deduction the person is allowed for the amount of depreciation loss is calculated using the formula—

disposal depreciation loss × qualifying use days ÷ all days

Definition of items in formula

(10) In the formula in subsection (9),—

(a) **disposal depreciation loss** is the amount resulting from a calculation made for the item under section EE 48(2):

(b) **qualifying use days** is the number of days in the income year on which the person owns the item and uses it, or has it available for use, for a use that falls within subsection (8)(c)(i) or (ii):

(c) **all days** is the number of days in the income year on which the person owns the item and uses it or has it available for use for any purpose.

Other units of measurement

(11) A unit of measurement other than days, whether relating to time, distance, or anything else, is to be used in the formula if it achieves a more appropriate apportionment.

EE 51 Amount of depreciation recovery income when lost or stolen items recovered

When this section applies

(1) This section applies when an item of property to which section EE 47(3) applies—

(a) is recovered in a later income year; and

(b) is still owned by the person; and

(c) is still used or available for use by the person.

Person treated as acquiring item

(2) The person is treated as having acquired the item, on the date of recovery, for its adjusted tax value at the start of the income year in which it was lost or stolen.

Person treated as deriving income: amount

(3) The person is treated as deriving an amount of depreciation recovery income equal to the amount of depreciation loss that the person has under section EE 48(2) for which they have been allowed a deduction.

Person treated as deriving income: income year

(4) The income year in which the person derives the depreciation recovery income is—

(a) the income year in which the item is lost or stolen, if the person chooses that year; or

(b) the income year in which the item is recovered, in any other case.

EE 52 Amount of depreciation recovery income when compensation received

When this section applies

(1) This section applies when a person receives insurance, indemnity, or compensation for an item of property to which this section applies, as described in section EE 46, other than for an item that is lost, stolen, or irreparably damaged.

Compensation subtracted

(2) An amount must be subtracted from the item's adjusted tax value. The amount is the amount by which the insurance, indemnity, or compensation that the person receives is more than the expenditure that the person incurs because of the event for which the person receives the insurance, indemnity, or compensation.

Depreciation recovery income

(3) If the item's adjusted tax value becomes negative in an income year through the application of subsection (2), the negative amount is an amount of depreciation recovery income derived by the person in the income year.

Compensation derived when item no longer owned

(4) If, in the absence of this subsection, the person would derive the amount of insurance, indemnity, or compensation after ceasing to own the item, the person is treated as deriving the amount immediately before the person ceases to own the item.

EE 65 Meaning of maximum pooling value

Meaning

(1) Maximum pooling value, for an item of depreciable property, means the greater of—

(a) $5,000; and

(b) the value set in a determination issued under section 91AAL of the Tax Administration Act 1994 applying to the item.

Increase in specified sum

(2) The Governor-General may make an Order in Council increasing the sum specified in subsection (1)(a).

[The maximum pooling value was increased from $2,000 to $5,000 on 1 July 2015 by the Income Tax (Maximum Pooling Value) Order 2015 with application to the 2015-16 and later income years.]

EE 66 Meaning of poolable property

Meaning

(1) **Poolable property**, for an income year, means an item of depreciable property that a person owns to which subsections (2) to (4) apply.

Not a building

(2) The item is not a building.

Maximum pooling value or globo method

(3) The item—

(a) is acquired in the income year for a cost equal to or less than its maximum pooling value; or

(b) was previously accounted for separately but has, as at the start of the income year, an adjusted tax value equal to or less than its maximum pooling value; or

(c) was accounted for at the end of the 1992–93 income year using, with the Commissioner's permission, the globo accounting method.

Wholly used or subject to fringe benefit tax

(4) The item—

(a) is wholly used or available for use by the person in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(b) to the extent to which it is not wholly used or available for use by the person in deriving assessable income or carrying on a business for the purpose of deriving assessable income, is used in a way that is subject to fringe benefit tax.

6. Section EJ 23 states:

EJ 23 Allocation of deductions for research, development, and resulting market development

When this section applies

(1) This section applies when a person has—

(a) a deduction for expenditure incurred on research or development that the person chooses to allocate under section DB 34(7) (Research or development):

(b) a deduction for an amount of depreciation loss for an item used for research or development, that the person chooses to allocate under section EE 1(5) (What this subpart does):

(c) a deduction for expenditure incurred on market development for a product that has resulted from expenditure incurred on research or development that the person chooses to allocate under section EJ 22(2).

Timing of deduction

(2) The person must allocate the deduction to an income year—

(a) in which the person derives an amount of income that is assessable income that the person would not have derived but for—

(i) expenditure that gives rise to a deduction that may be allocated under this section:

(ii) the use or disposal of an item for which the person has an amount of depreciation loss that may be allocated under this section:

(b) to which under Part I (Treatment of tax losses) a loss balance is carried forward for the income year in which the expenditure or depreciation loss was incurred.

Minimum amount of deduction allocated to income year

(3) The person must not allocate to an income year (the current year) an amount of deductions referred to in subsection (1) that is less than the lesser of—

(a) the amount of assessable income referred to in subsection (2)(a) that the person derives in the current year:

(b) the amount of the deductions that have not been allocated to an income year before the current year.

Maximum amount of deduction allocated to income year

(4) The person must not allocate to an income year (the current year) an amount of deductions referred to in subsection (1) that is more than the greater of—

(a) the amount of assessable income referred to in subsection (2)(a) that the person derives in the current year:

(b) the amount of the deductions that—

(i) arise in other income years from which a loss balance may be carried forward under Part I to the current year; and

(ii) have not been allocated to income years before the current year.

7. The relevant provisions from subpart FA state:

FA 6 Recharacterisation of amounts derived under finance leases

When a personal property lease asset is leased under a finance lease, the lease is treated as a sale of the lease asset by the lessor to the lessee on the date on which the term of the lease starts, and—

(a) the lessor is treated as giving a loan to the lessee for the lease asset; and

(b) the lessee is treated as using the loan to buy the lease asset; and

(c) subpart EE (Depreciation), the financial arrangements rules, and the other provisions of this Act apply to the arrangement as recharacterised.

FA 7 Determining amount of loan

Value to lessor

(1) For a lessor under a finance lease, the amount of the loan is determined under section EW 32 (Consideration for agreement for sale and purchase of property or services, hire purchase agreement, specified option, or finance lease).

Value to lessee

(2) For a lessee under a finance lease, the amount of the loan is determined under sections EW 32 and EW 33 (which relate to the value of consideration under the financial arrangements rules).

FA 8 Deductibility of expenditure under finance lease

Lessee treated as owner

(1) The lessee under a finance lease is treated as the owner of the personal property lease asset for the purposes of subpart EE (Depreciation).

Lessor not treated as owner

(2) The lessor under a finance lease is not treated as the owner of the personal property lease asset for the purposes of subpart EE.

FA 9 Treatment when lease ends: lessee acquiring asset

Acquisition treated as sale

(1) When a lessee under a finance lease acquires the personal property lease asset by the date on which the term of the lease ends, the acquisition is treated as the same sale that is treated as occurring under section FA 6.

When lessee or associated person acquires lease asset and later disposes of it

(2) If a lessee under a finance lease, or a person associated with them, acquires the lease asset and later disposes of it for an amount that is more than the consideration they paid for it, the excess is income of the lessee under section CC 11 (Lessee acquiring lease asset on expiry of term of lease).

Allocation and association

(3) For the purposes of subsection (2),—

(a) the excess is income of the lessee in the income year in which the lessee or associated person disposes of the asset:

(b) association is determined at the time of acquisition by the associated person.

Exception

(4) Subsection (2) does not apply if the consideration derived on the disposal is income of the lessee or an associated person under a provision of this Act other than this section.

FA 10 Treatment when lease ends: lessor acquiring asset

When this section applies

(1) This section applies when a finance lease ends by the date on which its term ends.

Acquisition by lessor at end of lease

(2) If the lessee does not acquire the personal property lease asset by the date on which the term of the lease ends, the lessor is treated as having acquired it on that date at its guaranteed residual value. If there is no guaranteed residual value, the consideration is treated as zero. In this section, the consideration is called the **notional sale price**.

Further sale, assignment, or lease

(3) Subsections (4) and (5) apply when the lessor sells, assigns, or leases the lease asset to another person under another finance lease on or after the date on which the term of the original lease ends.

When consideration more than notional sale price

(4) If the consideration is more than the notional sale price,—

(a) to the extent to which it is paid by the lessor to the lessee under the original finance lease, the notional sale price is increased by the amount of the difference; and

(b) to the extent to which it is not paid by the lessor to the lessee under the original finance lease, the amount of the difference is income of the lessor under section CC 12 (Lessor acquiring lease asset on expiry of term of lease) in the income year in which the original lease term ends.

When consideration less than notional sale price

(5) If the consideration is less than the notional sale price, and the lessee is required to pay the amount of the deficit to the lessor, the notional sale price is reduced by that amount.

Acquisition by lessor when lease ends early

(6) If the lease is terminated before the end of its term and the lessee does not acquire the lease asset, the lessor is treated as acquiring it for an amount calculated using the formula—

outstanding balance − release payment.

Definition of items in formula

(7) In the formula,—

(a) **outstanding balance** is the amount of the outstanding balance of the loan on the date on which the lease is terminated:

(b) **release payment** is the amount the lessee paid to be released from their obligations under the lease.

Relationship with section EE 45

(8) Subsections (2) to (6) override section EE 45 (Consideration for purposes of section EE 44).

FA 11 Adjustments for leases that become finance leases

When this section applies

(1) This section applies when a lease is entered into on or after 20 May 1999 and—

(a) the lease is a consecutive or a successive lease—

(i) that is treated as 1 lease under the definition of **lease**; and

(ii) with a term of the lease that the lessor and lessee do not contemplate, at the start of the term, will be more than 75% of the personal property lease asset's estimated useful life; and

(iii) with a term of the lease that is more than 75% of the asset's estimated useful life:

(b) the lease is an operating lease that becomes a finance lease under paragraph (c) of the definition of **finance lease**.

Adjustment required

(2) The lessor and lessee must each adjust their income and expenditure calculated for the lease by including an adjustment in a return of income for the tax year corresponding to the income year in which the lease becomes a finance lease.

Amount of adjustment

(3) The amount of the adjustment is calculated for the relevant person in relation to the period described in subsection (5) using the formula—

finance income − finance expenditure − unadjusted income + unadjusted expenditure.

Definition of items in formula

(4) In the formula,—

(a) **finance income** is the income that would have been derived by the person under the lease if the lease were a finance lease for the period:

(b) **finance expenditure** is the expenditure that would have been incurred by the person under the lease if the lease were a finance lease for the period:

(c) **unadjusted income** is the income derived by the person under the lease:

(d) **unadjusted expenditure** is the expenditure incurred by the person under the lease.

Adjustment period

(5) The period starts on the date on which the lease starts and ends on the last day of the income year in which the lease becomes a finance lease.

Adjustment positive

(6) If the adjustment is positive, the amount is income of the relevant person under section CH 6 (Adjustments for certain finance and operating leases).

Adjustment negative

(7) If the adjustment is negative, the amount is a deduction of the relevant person under section DB 51B (Adjustments for leases that become finance leases).

FA 11B Adjustments for certain operating leases

When this section applies

(1) This section applies when a lease is an operating lease that—

(a) is entered into on or after 20 May 1999 and before 20 June 2007; and

(b) is an arrangement, or part of an arrangement that, on 20 June 2007, meets the requirements of paragraph (c)(i) to (iii) of the definition of **finance lease**; and

(c) has a term of the lease ending after the end of the income year in which 20 June 2007 falls (the **adjustment year**); and

(d) does not meet the requirements of section FA 11(1) before the end of the income year after the adjustment year.

Adjustment required

(2) The lessor must adjust their income and expenditure calculated for the lease asset by including an adjustment in a return of income for the tax year corresponding to the income year after the adjustment year.

Amount of adjustment

(3) The amount of the adjustment is calculated using the formula—

total depreciation losses ÷ 6

Definition of item in formula

(4) In the formula, total depreciation losses is the total amount of depreciation loss for the lease asset for which the lessor is allowed a deduction in the period that begins with the start of the term of the lease and ends with the end of the adjustment year.

Income

(5) The amount of the adjustment is income of the lessor under the lease under section CH 6 (Adjustments for certain finance and operating leases) in the income year after the adjustment year.

Adjusted tax value

(6) The adjusted tax value of the lease asset at the beginning of the income year after the adjustment year is the total of the amount of the adjustment and the adjusted tax value that the lease asset would have in the absence of this section.

Depreciation loss

(7) For an income year beginning after 20 June 2007 in which the lease is an operating lease, the amount of depreciation loss allowed for the lease asset other than under section EE 48 (Effect of disposal or event) is five-sixths of the amount of depreciation loss that would be allowed for the lease asset in the absence of this subsection.

8. Schedule 14 states:

…

7 the copyright in software, the right to use the copyright in software, or the right to use software

…

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.

OS 16/01: FILING AN IR10 AND SECTION 108 OF THE TAX ADMINISTRATION ACT 1994

Introduction

This statement sets out the Commissioner of Inland Revenue's preference for the ways in which taxpayers may bring income to her attention when filing their annual return. Other than the return itself, other common ways are to complete the *Financial statements summary (IR10)* or to include a set of financial statements with their annual return.[1]

The Commissioner's preference is that this information is provided using the IR10. This is because receiving the information via the IR10 significantly reduces the administrative costs to Inland Revenue in processing the data for use by Inland Revenue, other government agencies (such as Statistics New Zealand) and the private sector. An exception to this are significant enterprises,[2] as the Commissioner requires these taxpayers to provide a package of information (including financial statements) for risk assessment.

Inland Revenue has made several statements about income disclosure by taxpayers who complete an IR10, rather than provide their financial statements when furnishing their annual tax return, and the impact of this on the time bar under s 108(2) of the Tax Administration Act 1994. These statements are:

- *Tax Information Bulletin* Vol 3, No 5 (March 1992): 11
- *Tax Information Bulletin* Vol 5, No 3 (September 1993): 1
- *Tax Information Bulletin* Vol 6, No 13 (May 1995): 13
- *Tax Information Bulletin* Vol 10, No 3 (March 1998): 40, and
- *Agents Answers*, Issue 133 (March 2011): 1.

This statement amalgamates and replaces these items, and will apply to all decisions that may require the re-opening of a return of income made on or after 26 May 2016. This statement applies to the current IR10 (for returns filed for the 2012-2013 and later income years) and the old IR10 *Accounts information form* (for returns filed for the 2011-12 and earlier income years).

This statement also appears in *Tax Information Bulletin* Vol.28, No.6 (July 2016).

Unless specified otherwise, all legislative references in this statement refer to the Tax Administration Act 1994.

Background

1. In 2012, the IR10 form was redesigned. The revised form allows taxpayers greater ability to disclose income, gains and receipts (which may or may not be necessarily classed or returned as taxable income), and also limits the potential for discrepancies between amounts recorded on the IR10 and what is contained in a taxpayer's financial statements. Some unnecessary items were also removed.
2. The changes mean the IR10 form is now more aligned with financial statements. It also collects better data to help inform Government decisions, creates administrative savings for Inland Revenue and reduces compliance costs for some taxpayers.
3. The insertion of new data boxes provides greater opportunity for taxpayers to disclose income. The data boxes that were added to assist in greater disclosure are:
   - Box 26 Exceptional items
   - Box 28 Tax adjustments, and
   - Box 53 Untaxed realised gains/receipts.

Application

The Time Bar

4. Under s 108, if a taxpayer furnishes a tax return and an assessment has been made, the Commissioner is unable to amend that assessment to increase the tax payable if four years have passed from the end of the tax year in which the taxpayer provided the tax return. This is referred to as the time bar. Section 108 provides:

108 Time bar for amendment of income tax assessment

(1) Except as specified in this section or in section 108B, if—

[1] A *Statement in support of a tax interpretation (IR282)* is another form that can accompany the return to help explain and support a taxpayer's interpretation or tax position. This form can be found at **www.ird.govt.nz**

[2] The Commissioner considers "significant enterprises" to be customer groups of companies with a gross turnover of greater than $80 million per annum where otherwise notified they are subject to the Basic Compliance Package process, or operating in specialist industries or subject to specialised tax laws.

(a) a taxpayer furnishes an income tax return and an assessment has been made; and

(b) 4 years have passed from the end of the tax year in which the taxpayer provides the tax return,—

the Commissioner may not amend the assessment so as to increase the amount assessed or decrease the amount of a net loss.

…

(1B) Despite subsection (1), the Commissioner may not amend an assessment so as to increase an amount of research and development tax credit under section LH 2 of the Income Tax Act 2007 if—

(a) a taxpayer furnishes an income tax return for the 2008–09 or a later tax year; and

(b) 2 years have passed from the latest date to provide a return of income for the relevant tax year and, for a member of an internal software development group to which section 68E applies, the latest date means the latest date for any member of the group; and

(c) the taxpayer—

(i) has not issued a notice of proposed adjustment to the Commissioner for an amount of a tax credit for research and development expenditure for the relevant tax year within the relevant response period; and

(ii) has not asked for an assessment to be amended under section 113, having provided a detailed research and development statement under section 68D or 68E, as applicable, within the time limit referred to in paragraph (b).

(2) If the Commissioner is of the opinion that a tax return provided by a taxpayer—

(a) is fraudulent or wilfully misleading; or

(b) does not mention income which is of a particular nature or was derived from a particular source, and in respect of which a tax return is required to be provided,—

the Commissioner may amend the assessment at any time so as to increase its amount.

...

5. If the Commissioner is of the opinion that the tax return provided by a taxpayer is fraudulent or wilfully misleading, or the return does not mention income of a particular nature or that was derived from a particular source, the Commissioner may amend the taxpayer's assessment, despite the time bar: s 108(2). This is irrespective of the manner in which the income, receipt or gain has been returned to the Commissioner (ie by a financial statement or IR10).

6. Before amending an assessment that has been time barred, the Commissioner must form the requisite opinion under either para (a) or para (b) of s 108(2).

7. In *Vinelight Nominees Ltd & Anor v Commissioner of Inland Revenue (No 2)* (2005) 22 NZTC 19,519 (HC), Lang J referred to the requisite opinion as "but one of the steps to be taken by the Commissioner before he issues an assessment" (at [26]).

8. Another step is that the formation of the opinion satisfies a threshold requirement of being made in good faith on the evidence available. Willy DJ explained this more fully in Case Q58 (1993) 15 NZTC 5,330, with reference to the earlier decision of the Court of Appeal in *Maxwell v CIR* [1962] NZLR 683. At 5,349, Willy DJ stated:

> It is therefore all the more important in my view that the caution expressed by Gresson P in *Maxwell* (above) that the Commissioner, and by extension this Court should act bona fide, and with a sense of responsibility in first forming an opinion. It is not until that opinion is formed that any onus rests on the objector to show an absence of fraud, or conduct which could be described as wilfully misleading.

9. Whether the tax return is fraudulent or wilfully misleading will depend on the individual circumstances of each case. Under s 149A(2), the onus of proof is on the taxpayer in all civil matters, except evasion. Therefore, if an opinion has been formed that a tax return is fraudulent or wilfully misleading, the taxpayer will need to disprove the Commissioner's view.

10. If the return does not mention income of a particular nature, it does not need to be a fraudulent, deliberate or intentional act to permit the Commissioner to amend an assessment (see *Babington v CIR* [1957] NZLR 861 (SC) at 869).

11. Whether income of a particular nature, or income derived from a particular source, has been mentioned or omitted also depends on the circumstances of each case. In *Cross v CIR* (1987) 9 NZTC 6,101 (CA), McMullin J stated at 6,110:

> It is neither possible nor practical to lay down a rule of general application by which questions of alleged omission of particular sources of income can be judged. Whether there has been an omission of 'all mention of income' must be considered in the circumstances of each case.

12. The court also held that it is not necessary for a taxpayer to return the income as assessable, as it is sufficient for the taxpayer to mention, or draw the Commissioner's attention to, the income in the tax return. How far one needs to go then becomes a matter of fact and degree. See *Cross v CIR*; Case M102 (1990) 12 NZTC 2,634.

13. The Commissioner must be able to form her own views as to the correct treatment of the item based on the information provided by the taxpayer. What facts are relevant and whether a taxpayer has done enough to draw an item to the Commissioner's attention again depends on the circumstances of each case.

Decision to reopen or not reopen an assessment

14. Once the Commissioner has formed the view that there has been an omission of all mention of income (which is of a particular nature or was derived from a particular source) or considers that the tax return is fraudulent or wilfully misleading, the Commissioner's next step is to decide whether to reopen an assessment under s 108(2).

15. The Commissioner's ability to use s 108(2) is a discretionary power, which does not have to be exercised in every case. In deciding whether to reopen a time-barred assessment, the Commissioner will need to consider ss 6 and 6A:

6 Responsibility on Ministers and officials to protect integrity of tax system

(1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.

(2) Without limiting its meaning, the integrity of the tax system includes—

(a) taxpayer perceptions of that integrity; and

(b) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; and

(c) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and

(d) the responsibilities of taxpayers to comply with the law; and

(e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and

(f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

6A Commissioner of Inland Revenue

(1) The person appointed as chief executive of the department under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.

(2) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

(3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—

(a) the resources available to the Commissioner; and

(b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and

(c) the compliance costs incurred by taxpayers.

16. The Commissioner is required to maximise the collection of revenue. Therefore, there is the expectation that the Commissioner will generally amend an assessment. Under s 6A, the Commissioner may elect to forgo the immediate collection of revenue if it is considered that the course of action (not reopening the time-barred assessment) will "collect over time the highest net revenue that is practicable within the law". In making such a decision, the Commissioner will have regard to:

- the resources available to her (s 6A(3)(a));
- the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts (s 6A(3)(b)); and
- the compliance costs incurred by taxpayers (s 6A(3)(c)).

17. Furthermore, under s 6, the Commissioner is also required to consider whether the decision not to reopen a time-barred assessment will protect the integrity of the tax system.

Reconstructed income, aggressive tax schemes or tax avoidance

18. The operational approach set out in this statement is intended to apply to cases where an IR10 is filed instead of a financial statement and also generally where the limitations of the IR10 form inhibits the disclosure of income. However, there are two circumstances - reconstructed income and aggressive tax schemes or tax avoidance - where this statement will not apply if an IR10 is filed (instead of a financial statement).

19. Amounts that have been reconstructed by the Commissioner under s GA 1 of the Income Tax Act 2007 (also known as reconstructed income) are either practically or highly unlikely to have been recorded on the IR10, financial statements or the taxpayer's returns. Consequently, this statement could not apply to those situations.

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20. It also follows that the Commissioner will not want to fetter her discretion to reopen (or not reopen) an assessment that is time barred by the application of this statement in cases where she is of the view that the taxpayer is involved in an aggressive tax scheme or tax avoidance.[3]

21. In the circumstances above, the Commissioner still has the discretionary power under s 108 to determine whether the taxpayer has fraudulently or wilfully misled the Commissioner or whether there has been an omission of income.

22. Due to the importance of reopening the time bar to both the Commissioner and taxpayers, decisions to reopen a time-barred assessment in relation to tax avoidance cases that potentially involve reconstructed income will be subject to the Critical Task Assurance process. Critical Task Assurance is intended to ensure that key pieces of work are subject to an independent review by the Legal and Technical Services unit of Inland Revenue before being issued.

IR10 Application

Section 108(2)(a) Fraudulent and wilfully misleading

23. If a tax return is fraudulent or wilfully misleading, irrespective of the manner in which the income, receipt or a gain is returned (or not returned), the Commissioner has the ability to reopen an assessment.

Section 108(2)(b) Omission of income

24. Where a taxpayer has filed a fully completed IR10, and the IR10 is consistent with the financial statements, the taxpayer will be afforded the same protection of the time bar as would apply had the taxpayer provided their financial statements. This is in line with current Inland Revenue practice, as well as previously published statements by the Commissioner.

25. The operational approach of the Commissioner where an IR10 has been filed (subject to [18]-[22] of this Operational Statement) is as follows:

- If the IR10 discloses the income, gain or receipt, the time bar will apply.
- Where the IR10, although fully completed and consistent with the financial statements, does not disclose the income, gain or receipt due to limitations in the IR10 form, the following approach will be adopted:
  - If the unfiled financial statements disclose the income, gain or receipt, the return will not be amended even though the financial statements were not sent to Inland Revenue at the time the income tax return was filed.
  - If neither the IR10 nor the unfiled financial statements disclose the income, gain or receipt, the return will be subject to a review by senior Service Delivery management to determine whether the time bar applies.

Examples of limitations of the IR10

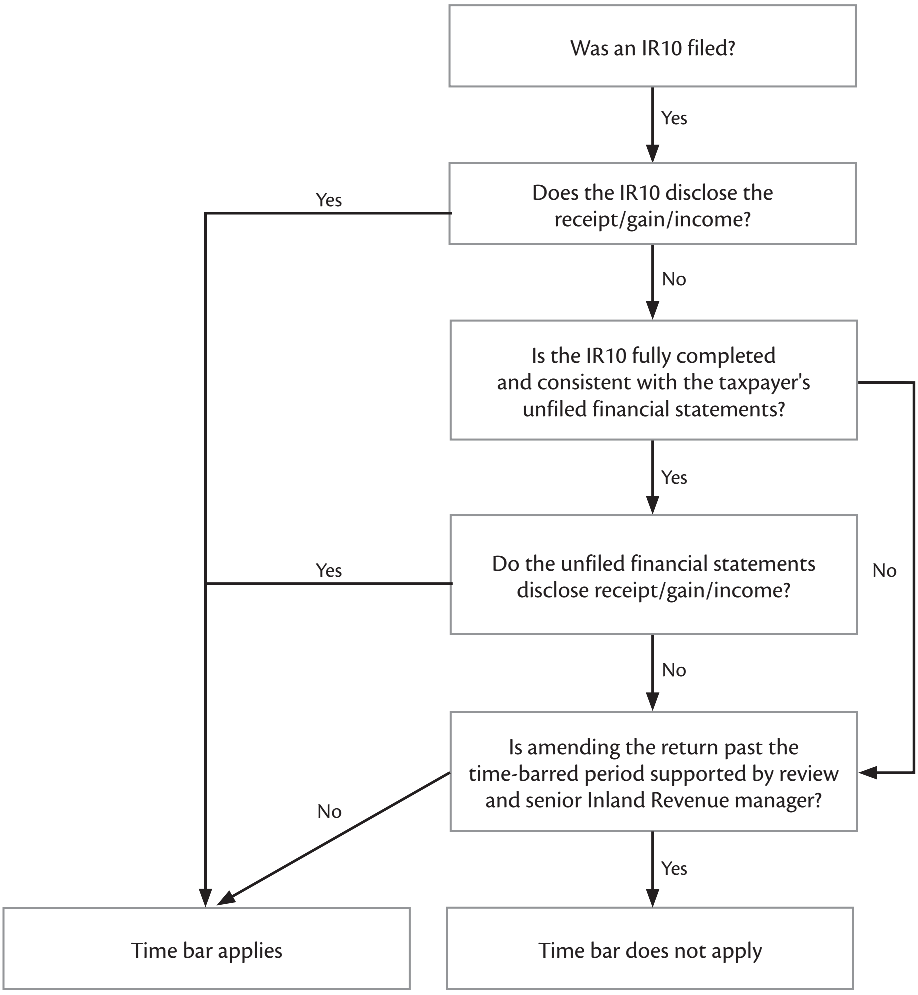
Taxpayer A files an IR10 with nothing in box 53 for "Untaxed realised gains/receipts" or box 55 for "Disposals of fixed assets". The Commissioner learns that the taxpayer was dealing in land or other fixed assets. Although the taxpayer disclosed the sales in their financial statements, which were not provided to the Commissioner, the taxpayer should have disclosed the sales in box 53 or box 55. Therefore, in this case, more information from the taxpayer will be required as to why the sales were not disclosed in the appropriate box before the Commissioner can form her view regarding the time bar.

Taxpayer B files an Account Information IR10 with his 2010 tax return. In 2016, the Commissioner finds the taxpayer has not returned a $250,000 gain on the sale of a share. This gain was disclosed in the financial statements, but was not returned on the basis that the gain was a capital receipt. The financial statements were not attached to the taxpayer's 2010 tax return. A fully completed Account Information IR10 accompanied the taxpayer's 2010 tax return. The IR10 did not disclose the $250,000 gain because it did not request any information about untaxed realised gains/receipts. Under this Operational Statement, the time bar will apply.

26. This means taxpayers will get the same benefit of the time bar without having to send in their financial statements to Inland Revenue. Any decision to reopen an assessment will be made once the taxpayer's IR10 and their financial statements (which will be requested as part of an investigation) are analysed. Consequently, taxpayers who file an IR10 will only need to send their financial statements to Inland Revenue if they are requested to do so.

[3] More information on the Commissioner's view of the law on tax avoidance in New Zealand is outlined in *IS 13/01 Tax Avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007*, available at **www.ird.govt.nz/technical-tax/interpretations/2013/**

27. This approach can be reflected as follows:



28. Any recommendation by an Inland Revenue officer to reopen the time bar due to an omission of income will also be subject to Critical Task Assurance and review by a senior manager. The review and consideration by a senior manager will take place as early as possible, and before a letter or notice is issued to the taxpayer advising that it is proposed to amend the return(s).

29. When deciding whether to amend an assessment, senior management will consider relevant factors, including the nature and amount of the income omitted and the circumstances leading to the omission of income.

This Operational Statement is signed on 26 May 2016.

Rob Wells
LTS Manager – Technical Standards

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 16/02: CHILD SUPPORT AND DOMESTIC MAINTENANCE – AMENDMENTS TO ASSESSMENTS

Introduction

Standard Practice Statements describe how the Commissioner of Inland Revenue (the Commissioner) will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Standard Practice Statement (SPS) sets out how the Commissioner will exercise the discretion under s 87 of the Child Support Act 1991 (the Act) to amend assessments for child support and domestic maintenance to give effect to the Act. This includes assessments the Commissioner makes as a result of a voluntary agreement entered into by parties.

Throughout this SPS, references to "financial support" include child support and domestic maintenance. References to a "carer" includes both parent and non-parent carers.

Unless specified otherwise, all legislative references in this SPS are to the Child Support Act 1991.

Application

This SPS applies from 30 May 2016.

This SPS does not apply to requests to depart from the formula assessment of child support. If the parent or carer considers the formula assessment is not fair because it does not fit their particular circumstances, they can apply for an administrative review under Part 5A or 6A, or a departure under s 104. Section 87 cannot be used as an alternative to these processes.

This SPS also does not apply to the amendment of the amount of outstanding child support debt or penalties where the calculation of child support was itself correct.

This SPS should be read in conjunction with:

IR174 Helping you to understand child support and the Family Court

IR175 Helping you to understand child support reviews

IS 10/07 Care and management of the taxes covered by the Inland Revenue Acts – Section 6A(2) and (3) of the Tax Administration Act 1994 (*Tax Information Bulletin* Vol 22, No 10 (November 2010): 17)

Status of the Commissioner's advice (*Tax Information Bulletin* Vol 24, No 10 (December 2012): 86)

If a customer is not satisfied with the level of service they receive from Inland Revenue, they can obtain more information about the Complaints Procedure at: **www.ird.govt.nz/aboutir/who-we-are/structure/complaints/**

Standard practice

Summary

1. Section 87 of the Child Support Act 1991 gives the Commissioner a wide discretion to amend any assessment at any time where it is considered the changes are necessary to give effect to the Act. The amendments can apply to assessments for the current child support year, a future year, or to past years (in which case parties may receive, or be required to make, payments for previous years). A child support year runs from 1 April to 31 March of the following year.
2. The Commissioner is not limited as to the number of years for which past year assessments can be amended. In the past, Inland Revenue's practice has been to amend all incorrect assessments over a number of years. The Commissioner no longer considers this to be the best approach for dealing with s 87 amendments, as it uses considerable Inland Revenue resources and also has the potential to create uncertainty for parents or carers. Instead, the practice now is for the Commissioner to consider the circumstances of individual cases before making changes to past years. This is because any changes will generally result in opposite effects for the parties involved. The liable parent will be required to pay more (or less) than originally assessed and the receiving carer will receive more (or less) than originally assessed. Changes to assessments could also result in the obligations of the parties being reversed, so that the receiving carer becomes the liable parent and vice versa.

3. There are a number of sections in the Act that specifically allow, and in some cases require, the Commissioner to amend an assessment. Section 87(3) also sets out situations where an assessment may be amended. The Commissioner may amend assessments in all of these cases, although assessments may also be amended outside of these specially defined cases. Section 87(4) and the opening words of s 87(3) make it clear that the Commissioner's power to amend assessments is not limited. All that is required is that the amendment is necessary to give effect to the Act.

4. Sections 6 and 6A of the Tax Administration Act 1994 set out the Commissioner's duties and responsibilities for the care and management of the various taxes. These provisions apply to child support, and the interpretation statement IS 10/07: *Care and management of the taxes covered by the Inland Revenue Acts - section 6A(2) and (3) of the Tax Administration Act 1994* will also apply.

5. This SPS states that the Commissioner is to consider all amendment requests made by parents or carers and errors identified by Inland Revenue staff. Before an assessment is amended, the amendment must be considered necessary to give effect to the Act. When considering whether an assessment should be amended, the Commissioner will consider the principles set out in this SPS. Not all assessments will necessarily be amended.

6. The time that an assessment is amended from will be determined by specific rules discussed below in [25], [26] and [32(a)]. These apply where the Commissioner considers the assessment should be amended, and where there has been a cessation event, a change in living circumstances, or an estimate and subsequent discovery of the correct taxable income by the Commissioner.

7. In all other cases, the time that the assessment is amended from will generally depend on when the particular change, event or error occurred (and therefore the assessment that it affects). If the change or event occurred in the current child support year, amendments will generally be made from the date that the particular change or event occurs.

8. Aside from the rules set out in [25] – [27], if the assessment relates to a period before the current child support year, amendments will generally be made from the start of the current year (subject to specified exceptions set out in [32]). This ensures a consistent and impartial treatment to all child support customers.

Detailed Discussion

When can an assessment be amended under section 87?

9. Section 87 applies to assessments of child support and domestic maintenance.

10. An assessment of child support can arise from a formula assessment determined under Part 2 of the Act, the acceptance of a voluntary agreement entered into by parties under Part 3 of the Act, or a court maintenance order under Part 4 of the Act:

    a) A formula assessment may be amended when any of the components of the formula assessment change, or when the child ceases to be a qualifying child. This includes, but is not limited to, situations where:

       i. the income of one or both of the parents changes;

       ii. the qualifying child moves into a different age bracket;

       iii. the dependent child allowance changes (for example, if the number of dependent children changes, the care cost percentage changes, or the dependent children move into a different age bracket);

       iv. the multi-group allowance changes (for example, when the number of children in a parent's other child support group changes);

       v. a change to the proportion of care that each parent or carer provides for the child (the care percentage) results in a change to the care cost percentage;

       vi. the qualifying child becomes financially independent;

       vii. the qualifying child lives with another person in a marriage, civil union or de facto relationship.

       It may also be necessary to amend an assessment where an independent decision has been made that an assessment should be amended. For example, an amendment may be necessary to comply with:

       viii. a court-ordered departure, or

       ix. a departure made under an administrative review.

    b) An assessment may also be amended when the Commissioner accepts a voluntary agreement of child support that has been entered into by the parties. This includes, but is not limited to, situations where:

i. the voluntary agreement between the parties is amended and the Commissioner accepts an application to administer the amended agreement;

ii. a court makes an order to cancel, vary, extend or suspend a voluntary agreement under s 32(2)(d) of the Property (Relationships) Act 1976;

iii. the payments under the voluntary agreement cease to be payable, for example, if the voluntary agreement expires.

11. An assessment of domestic maintenance can arise either from the acceptance of a voluntary agreement between parties, or from a court order. These assessments of domestic maintenance can be amended in various situations, including when:

    a) both parties agree to amend their voluntary agreement, or

    b) a court orders the amendment.

12. Amendments to child support assessments can either be initiated when the Commissioner becomes aware of new information affecting a child support assessment, or be requested by parents or carers (for example, after a change in circumstances that affects the calculation of financial support).

13. If a parent or carer considers that the formula assessment does not adequately take into account their circumstances, they can apply for a review. This is not covered by s 87 or this SPS. See principle (c) in [23] below, and the Inland Revenue guide *Helping you to understand child support reviews (IR175)* for more information.

Informing Inland Revenue about changes

14. A parent or receiving carer is required by law to advise Inland Revenue of any change in their living circumstances that may affect their care cost percentage, any allowances, or their multi-group cap (if applicable).

15. When a parent or carer becomes aware of any other change that may affect the amount of financial support they pay or receive, they should advise Inland Revenue at the earliest opportunity. This will ensure greater certainty for both parties. Furthermore, in some cases, failing to notify the Commissioner of changes is treated as an offence under s 208 of the Act. This includes failing to notify the Commissioner of changes in living circumstances or of a change of address.

16. It is best for all parties to inform Inland Revenue promptly regarding possible changes to assessments. Certainty works both ways. The Commissioner retains the discretion to amend (or not to amend) assessments at any time. This means that if Inland Revenue is advised of a change in circumstances well after the change or event took place, the Commissioner may consider the assessment should not be amended. Conversely, there may be good reason for the assessment to be amended and this could result in significant changes to an assessment at a later time. Advising Inland Revenue of changes as they come to light results in greater certainty of payments of financial support for all parties.

What information should be provided to Inland Revenue?

17. When advising the Commissioner about a change that could affect an assessment, the parent or carer should provide as much information and evidence as possible. Where relevant, the following information should be provided:

    a. A description of the event or change, including the background circumstances.

    b. The dates of events that affect the assessment.

    c. How the change or event was identified.

    d. If the amendment relates to a prior child support year and the Commissioner was not notified within 28 days of the change/event, an explanation of the delay in notifying Inland Revenue.

    In addition, the parent or carer should provide any other evidence they consider relevant. This may help to ensure the amendment request progresses more efficiently as the Commissioner may not need to request further evidence from the parent or carer. What is relevant will depend on the amendment being requested. In some instances, the Commissioner may verify information provided by the requesting party with other sources of information.

18. The Commissioner has secrecy obligations under part 4 of the Tax Administration Act 1994 and s 240 of the Child Support Act 1991 and therefore may not be able to divulge information provided by another party (including other parents or carers in the child support relationship).

19. There are exceptions to this. For example, s 240(2) specifically sets out communications that are permitted. Another example is s 96H which applies under an administrative review and allows the Commissioner to send documentation to the other parties to the application for the administrative review.

20. To ensure the Commissioner has the correct information and is able to make an accurate assessment, it is important that all available relevant information and supporting evidence is provided. The Commissioner may also ask for evidence for specific periods of time.

21. The Commissioner is legally able to act on the basis of the documents and information held by Inland Revenue, and is not required to conduct any enquiries or investigations or to require that any further information be supplied. However, the Commissioner will not amend an assessment where it is reasonably suspected that the information provided by a parent or carer may be false. To ensure the Commissioner has complete information, parents or carers should, as far as possible, proactively provide all relevant information.

Principles

22. An amendment to an assessment can only be made under s 87 if the Commissioner considers the amendment necessary to give effect to the Act. This will include amendments required to give effect to a formula assessment, a voluntary agreement accepted by the Commissioner, a court order or a legislative exemption under Part 5A of the Act.

23. The Commissioner is not required to, and will not necessarily, amend all assessments that are incorrect. As part of the care and management obligations, the Commissioner will weigh up a number of principles to decide whether to amend an assessment. These principles are explained below. Note that these principles are not listed in order of importance. The principles that apply and the weighting that they are given will depend on the particular fact situation.

(a) Giving effect to the Act

This involves considering what provision of the Act the amendment would give effect to. In many instances, even where it requires an assessment to be amended, the Act also provides a discretion for the Commissioner as to when to make the amendment.

The objects of the Act (set out in s 4) are:

- to affirm the right of children to be maintained by their parents
- to affirm the obligation of parents to maintain their children
- to provide that the level of financial support to be provided by parents for their children is to be determined according to their relative capacity to provide financial support and their relative levels of provision of care
- to ensure that parents with a like capacity to provide financial support for their children should provide like amounts of financial support
- to provide legislatively fixed standards in accordance with which the level of financial support to be provided by parents for their children should be determined
- to affirm the right of carers who provide significant care to children to receive financial support in respect of those children from a parent or parents of the children
- to enable carers of children to receive support in respect of those children from parents without the need to resort to court proceedings
- to ensure that equity exists between parents and, where applicable, carers, in respect of the costs of supporting children
- to ensure that obligations to birth and adopted children are not extinguished by obligations to stepchildren
- to ensure that the costs to the State of providing an adequate level of financial support for children and their carers is offset by the collection of a fair contribution from liable parents
- to provide a system whereby child support and domestic maintenance payments can be collected by the Crown, and paid by the Crown to those entitled to the money.

Therefore, the Commissioner must consider whether the objects will be met if either the status quo is retained and no amendment is made or the amendment is made to the assessment.

There are three situations where the current practice focuses on giving effect to the Act. First, where there has been a change in living circumstances, s 82 sets out the rules that must be applied for amending assessments. These rules are discussed further in [25].

Second, where the Commissioner has previously estimated taxable income under s 39 and later ascertains the correct amount of income, the assessment will be amended as if the correct amount is, and always has been, the person's taxable income. This is discussed further in [26].

Third, where there has been an event that means the liability to pay child support has ceased, the assessment must be amended. This applies to three situations: first, where there is a formula assessment and one of the events in s 25 of the Act has occurred; second, where there is a voluntary agreement and one of the events in s 62 of the Act has occurred; and

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third, where there is a court order in force and an event under s 71(c) or (d) of the Act has occurred. The Commissioner will amend from the date that the cessation event took place unless, after considering the other principles listed below, there are overriding reasons to amend from a different date.

(b) Length of time since the change or event

Generally, the older the period of reassessment, the less likely it is that an amendment will be made. This is because facts and circumstances are often harder to establish, making it difficult for the parties to provide reliable evidence to help substantiate a reassessment.

The Commissioner will consider the parent or carer's disclosure of information. In particular, where there has been a delay in informing Inland Revenue of the change or event, the Commissioner will consider the reasons for the delay. A parent or carer is expected to promptly notify the Commissioner of changes or events that affect a child support assessment.

(c) Other administrative options available

Where a parent or carer considers that the formula assessment calculated under the Act is not fair because it does not fit their particular circumstances, they can apply for an administrative review or a departure order. The rules relating to administrative reviews and departure orders are contained in Parts 6A, 6B and 7 of the Act. Section 87 cannot be used as an alternative to these processes. For further information on these processes, see the Inland Revenue publications *Helping you to understand child support and the Family Court (IR174)*, and *Helping you to understand child support reviews (IR175)*, available at **www.ird.govt.nz** (keywords: IR174 or IR175).

(d) Complexity

The law relating to the proposed or requested amendment must be clear and unambiguous. The Commissioner will not make an amendment where there is a complex, unresolved issue (for example, issues that are before a court or covered only by proposed new legislation yet to be passed by Parliament).

(e) Events or changes in the intervening years

When considering an amendment to a past-year assessment, the Commissioner will consider whether the parent or carer's situation is likely to have significantly changed over the period. For example, while an event requiring an assessment to be amended may have occurred five years ago, another change may have occurred three years ago that means the original amendment is not required to the same extent.

Making a retrospective amendment to a previous assessment might only be fair if the assessments for the intervening periods are also made.

(f) Voluntary compliance

Where possible, any decision to amend an assessment should not discourage the voluntary compliance of parents and carers with their legal obligations, including their obligations to provide information.

(g) Compliance costs

One of the care and management principles to be taken into account by the Commissioner when deciding whether to amend an assessment is the effect on compliance costs for the parents or carers.

(h) Vexatious requests

Amendment requests that relate to very small amounts of financial support, or requests that the Commissioner considers to be vexatious in nature, will not usually be agreed to. Whether an amount is a "very small amount" will depend on the facts of the case, the assessment period being considered and the circumstances of the individuals involved.

(i) Fraudulent or misleading behaviour

Assessments will be considered for amendment in all cases where it is suspected that the Commissioner has been fraudulently or wilfully misled in order to prevent the activity resulting in a benefit to the fraudulent party. This maintains the integrity of the tax system and adheres to the concept of fairness by treating all customers that fall into this category equally.

Where fraudulent or misleading behaviour is suspected, any proposed amendment will first be reviewed by a Team Leader or a Technical and Service Advisor (or higher) before it is made. This is to ensure that a stricter process is followed by Inland Revenue where an assertion of fraudulent or misleading behaviour exists, and because such cases typically involve more complicated facts.

(j) Effect of the error on future assessments

As far as possible, assessments should be correct. Where an error or a change in circumstances has occurred in the past that, if left uncorrected, would affect future assessments, this suggests the amendment should be made. Similarly, where an error occurred in the past, but the circumstances of the parents/carers have now changed so that the error is no longer applicable to their current assessment, this may suggest the amendment is less important.

(k) Inland Revenue communications

If the Commissioner is persuaded that the parent or carer has made an error as a direct result of relying on advice given to them by Inland Revenue officers, favourable consideration may be given to the exercise of the discretion.

(l) Party ultimately affected

Changes to assessments of child support will generally result in opposite effects for the two parties – eg, if the liable parent is required to pay more (or less) than originally assessed, then the receiving carer will receive more (or less) than originally assessed.

A consequence of the amendment may be that the obligations between the parties are reversed, so that the receiving carer becomes the liable parent, and the liable parent becomes the receiving carer.

On the other hand, it is not always the parent or carer themselves who are better or worse off. In some cases, where the parent or carer is the recipient of a benefit, the Government is the affected party. The Government is to be treated with no more or less importance than a natural person carer or parent.

(m) Resources

It is important to recognise that Inland Revenue does not have unlimited resources. The Commissioner must balance the time spent considering amendments to financial support with the time spent on other activities, and thereby meet the obligation under s 6(1) of the Tax Administration Act 1994 to protect the integrity of the tax system.

The Commissioner will be reluctant to make amendments where they would require the use of disproportionate amounts of Inland Revenue's resources. This is not to say that the Commissioner will only use minimal resources to determine whether to make amendments or will never agree to complex amendment requests. The extent and relevance of a parent or carer's disclosure will help the Commissioner determine the amount of resources needed to consider amendment requests. Ultimately, the allocation of resources will be determined on a case-by-case basis.

As noted in principle (h), amendment requests that relate to very small amounts of financial support will not usually be agreed to. Whether an amount is a "very small amount" will depend on the facts of the case, the assessment period being considered and the circumstances of the individuals involved.

To assist in the consideration of any amendment request, parents or carers should provide sufficient relevant information with their request to ensure that the facts and laws relating to the errors are clear and unambiguous. Determining unresolved factual or legal issues may require disproportionate amounts of Inland Revenue's resources such that an amendment request might be declined irrespective of the dollar amounts involved.

(n) Applying consistency

In general, where a change is going to affect more than one assessment or have more than one effect on an assessment, these amendments should be made consistently.

(o) Agreement between the parties

In the case of a voluntary agreement of financial support, an assessment is likely to be amended where all parties to the agreement mutually agree on an amendment.

Similarly, where parties to a formula assessment of child support mutually agree that an amendment should or should not be made, and no Crown monies are at stake, this may be taken into account by the Commissioner.

24. After considering the principles above, when the Commissioner decides that an assessment will be amended, all parties to the child support relationship will be notified where possible. When a decision is made not to amend an assessment, generally only the party who made the request will be notified.

Date to amend assessment(s) from

Changes in living circumstances

25. Where there is a change in living circumstances, s 82 of the Act applies and the following rules apply.

Every receiving carer must advise the Commissioner of any change in their living circumstances if it affects the determination of their care cost percentage. Every parent must advise the Commissioner of any change in their living circumstances that affects the determination of their care cost percentage, their appropriate living allowance, any dependent child allowance, any person's multi-group allowance, or any person's multi-group cap. The rules for when these changes are treated as occurring are set out below.

Date to amend assessments for change in living circumstances - Ordinary rules

Where the Commissioner is satisfied that a change of living circumstances has occurred, the assessment will be amended with effect from the date of the change where:

(i) the Commissioner was notified of the change within 28 days of the date on which the change occurred;

(ii) the change relates to a liable parent and it has the effect of increasing the amount of the parent's child support liability; or

(iii) the change relates to a receiving carer and it has the effect of decreasing the amount of child support payable in respect of that carer.

Where the Commissioner is satisfied that a change of living circumstances has occurred, the amendment will apply from the date that the notice of the change was received where:

(i) the change relates to a liable parent and it has the effect of decreasing the amount of the parent's child support liability; or

(ii) the change relates to a receiving carer and it has the effect of increasing the amount of child support payable in respect of that carer.

However, as noted above, if the Commissioner was notified within 28 days of the date on which the change occurred, then the change is treated as having occurred on the date of the change.

The application of the rules above may result in changes to assessments from previous years.

Conflicting dates

Where two or more parties notify the Commissioner outside the 28 day period and the application of the ordinary rules above would mean that the same change is treated as having occurred on different days for different people, the change will be effective for all parties *from the first date that notice was given to the Commissioner*.

Where at least one party notifies the Commissioner within 28 days of the event and at least one party notifies the Commissioner outside the 28 day period and the application of the ordinary rules above would mean that the same change is treated as having occurred on different days for different people, the change will be effective from *the date of the change.*

Estimating taxable income

26. Section 39 provides that where the Commissioner has requested certain income information to be provided and the person has failed to provide that information, the Commissioner may estimate the taxable income for that person and make an assessment on the basis of that estimate. If the Commissioner later ascertains the person's correct taxable income, the Commissioner is required to amend the formula assessment as if the newly ascertained amount is, and always has been, the person's taxable income.

End of year reconciliations

27. Where a parent or carer has estimated their income, an end-of-year reconciliation will be performed that may result in previous years' assessments being amended.

General rules

28. The words *as the Commissioner considers necessary* in s 87 indicate that it is for the Commissioner to determine when an amendment is required and to what extent. It follows that there will be situations where the Commissioner does not consider an amendment necessary or that a partial amendment would be appropriate.

29. When considering whether to amend an assessment, emotive considerations cannot be taken into account. The Child Support Act considers financial considerations and is not directly concerned with welfare issues; these are dealt with by other legislation.

30. For all decisions whether to amend an assessment, Inland Revenue will record notes in its internal system that set out the reasons for the decision.

31. If the Commissioner considers an amendment should be made, the extent to which assessments will be amended depends on the period in which the change or event occurred (and therefore the assessment that it affects). Where the change or event occurred in the current child support year, amendments will generally be made from the date that the particular change or event occurred.

32. Aside from the rules set out in [25]–[27] above, where the change or event affects assessments that are prior to the current child support year, amendments will generally be made from the start of the current year, and only the current year assessment will be amended. This is to ensure a consistent and impartial treatment to all child support customers, but is subject to the exceptions below.

(a) Exception 1: Cessation event. Where the liability to pay financial support has ended after one of the events outlined in ss 25, 62, or 71(c) or (d) has occurred, the assessment will be amended from the date that the cessation event took place unless, after considering the other principles listed above, there are overriding reasons to amend from a different date. However, where the assessment is at the minimum level and, with the amendment, would remain at the minimum level, then the assessment will only be amended from the start of the current child support year.

(b) Exception 2: This exception applies if a change took place in a child support year up to and including the year ending 31 March 2015 and that change relates to a dependent child who was included in a living allowance and who has now turned 19. Unless there are exceptional circumstances that warrant a different date to be used, the assessment will be amended from the date the child turned 19. Inland Revenue considers that it is reasonable to expect that, where a child included in a living allowance turns 19, the parents should notify Inland Revenue. They should not benefit where they have failed to do so. However, where the assessment is at the minimum level and, with the amendment would remain at the minimum level, then the assessment will only be amended from the start of the current child support year.

(c) Exception 3: Where there are exceptional or special circumstances that justify a different amendment date. The Commissioner would need a good reason to be satisfied that the circumstances are in fact exceptional to justify deviating from the ordinary process, and higher internal processes would need to be followed (eg, higher delegations, written submission required). One example of an exceptional circumstance is where there are multiple changes that affect the same assessment and, individually, not all the changes result in the same amendments or not from the same point in time.

This Standard Practice Statement is signed on 30 May 2016.

APPENDIX: SELECTED SECTIONS OF LEGISLATION

Child Support Act 1991

Note: The following provisions may have changed since this SPS was published. For the most up-to-date legislation see www.legislation.govt.nz and search: "Child Support Act 1991".

Section 4: Objects

The objects of this Act are—

(a) to affirm the right of children to be maintained by their parents:

(b) to affirm the obligation of parents to maintain their children:

(c) [Repealed]

(d) to provide that the level of financial support to be provided by parents for their children is to be determined according to their relative capacity to provide financial support and their relative levels of provision of care:

(e) to ensure that parents with a like capacity to provide financial support for their children should provide like amounts of financial support:

(f) to provide legislatively fixed standards in accordance with which the level of financial support to be provided by parents for their children should be determined:

(fa) to affirm the right of carers who provide significant care to children to receive financial support in respect of those children from a parent or parents of the children:

(g) to enable carers of children to receive support in respect of those children from parents without the need to resort to court proceedings:

(h) to ensure that equity exists between parents and, where applicable, carers, in respect of the costs of supporting children:

(i) to ensure that obligations to birth and adopted children are not extinguished by obligations to stepchildren:

(j) to ensure that the costs to the State of providing an adequate level of financial support for children and their carers is offset by the collection of a fair contribution from liable parents:

(k) to provide a system whereby child support and domestic maintenance payments can be collected by the Crown, and paid by the Crown to those entitled to the money.

Section 25: When liability to pay child support ceases

(1) A liable parent ceases to be liable to pay child support in respect of a qualifying child under a formula assessment on the day before the date on which the child—

(a) ceases to be a qualifying child; or

(b) is adopted; or

(c) dies.

(2) A liable parent ceases to be liable to pay child support under a formula assessment on the day the parent ceases to be a liable parent under section 17, or on the day before the date on which the parent—

(a) becomes a person who is none of the following:

(i) a New Zealand citizen:

(ii) a person who is ordinarily resident in New Zealand:

(iii) a person who is ordinarily resident in a country with which New Zealand has entered into a reciprocal agreement for the enforcement of child support; or

(b) becomes a person from whom child support may not be sought in respect of the child by reason of section 6(2); or

(c) dies.

STANDARD PRACTICE STATEMENTS

(3) A liable parent ceases to be liable to pay child support in respect of a particular receiving carer of a qualifying child under a formula assessment on the earliest of the following:

(a) if the receiving carer dies, on the earlier of the following:

(i) the 28th day after the date of death:

(ii) the day before the date on which a properly completed application for formula assessment is received by the Commissioner from a carer in place of the carer who has died:

(b) the day before the date on which the receiving carer ceases to provide at least 35% of ongoing daily care to the child:

(c) the day before the date on which the receiving carer starts to live, or resumes living, with the liable parent of the child in a marriage, civil union, or de facto relationship:

(d) in any case to which section 8(2) applies, the day before the date on which the carer ceases to be under a duty to make payments under section 363 of the Children, Young Persons, and Their Families Act 1989 in respect of the child:

(e) [Repealed]

(f) in a case where a voluntary agreement made in relation to the child between the liable parent and the carer is accepted by the Commissioner, the day before the date on which that voluntary agreement first applies, in accordance with section 59.

(4) Subsection (5) applies if the Commissioner accepts an election under section 27 to end a formula assessment as it applies in respect of a qualifying child.

(5) A liable parent ceases to be liable to pay child support in respect of the qualifying child under the formula assessment on –

(a) the day on which the Commissioner received the notice of election; or

(b) if the notice of election specified a later day on which the formula assessment as it applies in respect of the qualifying child is to end, that later day.

Section 39: Position where taxable income not readily ascertainable

(1) Where—

(a) the Commissioner is unable to readily ascertain a person's taxable income for the last relevant tax year; and

(b) the Commissioner has requested or required that person—

(i) to supply a return of income for the last relevant tax year; or

(ii) to supply an estimate of income for the last relevant tax year; or

(iii) to supply an estimate of the income expected to be derived in the child support year; or

(iv) to give information (whether orally or in writing), or to produce a document,—

(whether the requirement was made under this Act, or under the Income Tax Act 1976 or the Tax Administration Act 1994 or otherwise) for the purposes of ascertaining that taxable income; and

(c) the person has refused or failed to comply with the request or requirement,—

the Commissioner may, in making a formula assessment, estimate the taxable income derived by that person in the last relevant tax year.

(2) [Repealed]

(3) If—

(a) the Commissioner has applied subsection (1) in making a formula assessment; and

(b) the Commissioner subsequently ascertains the person's taxable income for the last relevant tax year (whether or not an assessment has been made under the Income Tax Act 1976 or the Tax Administration Act 1994 in respect of that year),—

the Commissioner shall, as soon as practicable, amend the formula assessment on the basis that the person's taxable income for the last relevant tax year is, and has always been, the subsequently ascertained taxable income.

Section 62: When payments under voluntary agreement cease to be payable

(1) A party to a voluntary agreement that has been accepted by the Commissioner under this Act shall cease to be liable under this Act to make payments under the agreement from whichever is the earliest of the following days:

(a) in relation to an agreement for the payment of child support in respect of a qualifying child to a carer of the child,—

(i) the day that the agreement expires:

(ii) the day before the day on which the liable parent would cease to be liable to pay child support in respect of that child under section 25:

(iii) the day before the day on which the agreement ceases to qualify for acceptance by the Commissioner in terms of section 48:

(iv) the day before the day on which a notice of election under section 64 takes effect:

(b) in relation to an agreement for the payment of domestic maintenance—

(i) the day that the agreement expires:

(ii) the day before either party to the agreement becomes a person who is neither a New Zealand citizen nor a person who is ordinarily resident in New Zealand:

(iii) the day before the day on which a notice of election under section 64 takes effect:

(iv) the day before the day either party dies.

(2) Nothing in this section affects the contractual liability of any party to a voluntary agreement.

Section 70: Election that Commissioner is not to enforce order

(1) The person to whom any money is payable in accordance with any order to which this Part applies may, by written notice given to the Commissioner, elect that the order be one to which this Part does not apply.

(2) The notice must be—

(a) in the appropriate approved form; and

(b) verified as required in the form of notice; and

(c) accompanied by such documents (if any) as are required by the form of notice to accompany the notice.

(3) If any such election is made,—

(a) nothing in this Part or any other provision of this Act shall apply to any money that becomes payable in accordance with the order after the date of the election; and

(b) any money payable in accordance with the order after the date of the election may, without prejudice to any mode of recovery, be enforceable in the same manner as a judgment given by the District Court in civil proceedings.

(4) An election made under subsection (1) shall be irrevocable.

Section 71: Period for which money payable under this Act

Any money payable under this Act in accordance with an order to which this Part applies is payable in relation to the days in the period commencing on the later of—

(a) 1 July 1992; and

(b) the day on which the order comes into force,—

and ending with the earlier of the following days:

(c) the day on which the order ceases to be in force; and

(d) the day on which an election made under section 70 takes effect.

Section 82: Parents and receiving carers to advise Commissioner of changes

(1) For the purpose of enabling the Commissioner to make or amend a calculation of child support payable in respect of a child in any child support year under a formula assessment, every parent and every receiving carer of the child must advise the Commissioner of any change in the parent's or carer's living circumstances occurring during the child support year that affects, or may affect, any of the following:

(a) in relation to parents and non-parent carers, the determination of the person's care cost percentage:

(b) in relation only to parents, the following:

(i) the person's appropriate living allowance:

(ii) the application or calculation of any dependent child allowance (if any):

(iii) the application or calculation of any person's multi-group allowance (if any):

(iv) the application or calculation of any person's multi-group cap (if applicable).

(2) If the Commissioner is satisfied that a relevant change of living circumstances has occurred, the change is to be treated as having occurred—

(a) on the date on which the change occurred, in any of the following cases:

(i) in relation to a liable parent, where the change has the effect of increasing the amount of the parent's child support liability:

(ii) in relation to a receiving carer, where the change has the effect of decreasing the amount of child support payable in respect of that carer:

(iii) where notice of the change is received by the Commissioner within 28 days after the date on which the change occurred; or

(b) on the date on which the Commissioner receives notice of the change, in either of the following cases (unless paragraph (a)(iii) applies):

(i) in relation to a liable parent, where the change has the effect of decreasing the amount of the parent's child support liability:

(ii) in relation to a receiving carer, where the change has the effect of increasing the amount of child support payable in respect of that carer.

(3) Every notification of a change must be accompanied by such documentation as the Commissioner requires.

(4) The Commissioner may disregard subsection (2), and may determine the date on which a particular change in living circumstances is to be treated as having occurred, in any case where 2 or more people give notice under this section relating to the same change, and the application of subsection (2) would result in the same change having to be treated as having occurred on different days in relation to different people.

Section 86: Commissioner to give effect to changed circumstances

(1) Where child support is payable in respect of a qualifying child and the Commissioner is notified, or otherwise becomes aware,—

(a) that the liability of a liable parent to pay child support to a carer in respect of the child has ceased in accordance with section 25 or 62; or

(b) that an event or change of circumstances has occurred that alters the respective liability or entitlement of any parent or carer of the qualifying child,—

the Commissioner shall, as soon as practicable, take such action as is necessary to take account of the event or change in circumstances (whether by amending any assessment or otherwise).

(2) Where domestic maintenance is payable by a liable spouse or partner under a voluntary agreement or an order of the court and either—

(a) payment is to cease, or the rate of payment is to reduce, on a particular day in accordance with that agreement or order; or

(b) the Commissioner is notified, or otherwise becomes aware,—

(i) of the death of either party to the agreement; or

(ii) that an event or change of circumstances has occurred that affects the annual rate at which domestic maintenance is payable under this Act,—

the Commissioner shall, as soon as practicable, take such action as is necessary to take account of the event or change in circumstances (whether by amending any assessment or otherwise).

(3) Nothing in subsection (1) or subsection (2) is to be taken to prevent the Commissioner from taking such action as the Commissioner considers appropriate to take account of the likely occurrence of an event or change of circumstances of which the Commissioner is notified or otherwise becomes aware (whether by amending any assessment or otherwise).

Section 87: Amendment of assessments

(1) The Commissioner may, at any time, amend any assessment by making such alterations and additions as the Commissioner considers necessary to give effect to this Act.

(2) Subsection (1) has effect despite the fact that—

(a) child support or, as the case may be, domestic maintenance has been paid under the assessment; or

(b) the child support year, or the part of the child support year, to which the assessment relates has ended; or

(c) proceedings are pending in a court having jurisdiction under this Act against or in relation to the assessment.

(3) Without limiting subsection (1), the Commissioner may amend any assessment for the purpose of—

(a) correcting any error or mistake (whether or not made by the Commissioner); or

(b) correcting the effect of any false or misleading statement made to the Commissioner; or

(c) giving effect to the happening of an event or change of circumstances to which the provisions of section 86 apply; or

(d) giving effect to a formula assessment of child support by the Commissioner; or

(da) giving effect to Part 5A; or

(e) giving effect to the acceptance of a voluntary agreement by the Commissioner; or

(ea) giving effect to a determination of the Commissioner under Part 6A or 6B; or

(f) giving effect to a decision or order of a court under Part 7.

(4) Where a provision of this Act expressly authorises the Commissioner to amend an assessment, that provision does not by implication limit the power of the Commissioner (whether under this section or otherwise) to amend the assessment.

(5) Except as otherwise expressly provided in this Act, every amended assessment is to be taken to be an assessment for all the purposes of this Act.

(6) In any case where—

(a) child support or domestic maintenance payable under an amended assessment is increased after the due date; and

(b) the Commissioner is satisfied that the matter giving rise to the increase did not result from any neglect or default by the person who is required to pay that child support or that domestic maintenance under the amended assessment,—

that person—

(c) shall pay by the due date the amount that would have been payable if the increase had not taken effect; and

(d) shall pay the amount of the increase within 30 days after the date of the amended assessment,—

and the Commissioner shall fix that date as the new due date for payment.

Section 208: Offences

Every person commits an offence against this Act who—

(a) fails to notify the Commissioner, as required by section 89ZC, of the matters referred to in that section; or

(b) fails to notify the Commissioner, as required by section 82, of changes in living circumstances; or

(c) makes a deduction that contravenes section 165; or

(d) [Repealed]

(e) fails to notify the Commissioner, as required by section 239(1), of any change to that person's address; or

(f) fails to comply with any requirement of the Commissioner pursuant to section 239(2); or

(g) provides any false document or any false statement or any false declaration or gives any false information, knowing it to be false, or being reckless as to whether it was false, or intentionally misleads or attempts to mislead the Commissioner or any other officer of the Inland Revenue Department in relation to any matter under this Act; or

(h) knowingly falsifies any records required to be kept under this Act; or

(i) obstructs any officer of the Inland Revenue Department acting in the discharge of that officer's duties or in the exercise of that officer's powers under this Act; or

(j) aids, abets, incites, or conspires with any person to commit any offence against this Act or against any regulation made under this Act.

Section 240: Secrecy

(1) For the purposes of this section,—

(2) For the purposes of the Tax Administration Act 1994, the following communications shall be deemed to be communications of matters made for the purpose of carrying into effect the provisions of this Act:

(a) the communication of such information as is necessary for the purpose of any prosecution under any Act of the Parliament of New Zealand or under the law of any country or territory outside New Zealand, or such information as the Commissioner considers desirable for the purpose of any investigation into any suspected offence being a prosecution or, as the case may be, an investigation in relation to—

(i) any threat made by a liable parent against the welfare of any carer of any child of that person or the welfare of that child; or

(ii) any threat made by a liable spouse or partner against the welfare of the person to whom the liable spouse or partner is required to make payments under this Act; or

(iii) any threat made by a liable person against the welfare of an officer of the Inland Revenue Department:

(b) the communication, to the person who, in relation to any liable person and to any financial support payable by the liable person under this Act, is the payee, of such information as the Commissioner considers desirable for the purpose of informing that person of the amount of any such financial support that is in arrear and unpaid by the liable person and the enforcement actions that have been taken or are proposed for the purpose of securing payment of that amount:

(ba) the communication from time to time, to the person who, in relation to any liable person and to any financial support payable by the liable person under this Act, is the payee, of such information as the Commissioner considers desirable for the purpose of informing that person, in relation to any period, of the amount of any such financial support that has been paid by the liable person for or during that period, and the date or dates on which the payment or payments have been made:

(c) the communication, to the chief executive of the department for the time being responsible for the administration of the Social Security Act 1964 or any officer of that department authorised in that behalf, of information for the purpose of—

(i) carrying into effect the provisions of this Act; or

(ii) carrying into effect the provisions of section 70A of the Social Security Act 1964:

(iii) [Repealed]

(d) the communication, to the chief executive of the department for the time being responsible for the administration of the Social Security Act 1964 or any officer of that department authorised in that behalf or the General Manager of Veterans' Affairs New Zealand, of information relating to the amount of financial support paid by the Commissioner pursuant to Part 9 of this Act to any person whose income is required to be determined for the purposes of the Social Security Act 1964 or the Social Welfare (Reciprocity Agreements, and New Zealand Artificial Limb Service) Act 1990 or Part 6 of the Veterans' Support Act 2014 or the New Zealand Superannuation and Retirement Income Act 2001:

(db) the communication, to the Chief Executive of the Ministry of Justice or any officer of the Ministry of Justice authorised in that behalf, of information for the purpose of carrying into effect subpart 4 of Part 5A:

(dc) the communication, to the Commissioner of Police or any Police employee authorised in that behalf, of information for the purpose of carrying into effect subpart 4 of Part 5A:

(e) the communication, to the Chief Executive of the Ministry of Justice or any officer of the Ministry of Justice authorised in that behalf, of information for the purposes of—

(i) the enforcement outside New Zealand of—

(A) child support liabilities; or

(B) maintenance liabilities,—

that arose under this Act or under the Family Proceedings Act 1980; or

(ii) the enforcement within New Zealand of child support or maintenance liabilities that arose under the law of a foreign country.

(3) Any person to whom this section applies—

(a) shall, if and when required by the Commissioner to do so, certify in the manner prescribed in subsection (5) that he or she has been shown, has read, and has understood the provisions of this section; and

(b) thereafter shall be bound to maintain and aid in maintaining the secrecy of all matters relating to the Inland Revenue Acts, including all Acts (whether repealed or not) at any time administered by or in the Inland Revenue Department or relating to such other functions as may from time to time be, or have been, lawfully conferred on the Commissioner which come to his or her knowledge; and

(c) shall not at any time communicate such matters to any person except for any purpose or purposes for which the Commissioner authorises such disclosure and to the extent that the Commissioner authorises such disclosure.

(4) Without limiting the generality of subsection (3), it is hereby declared that no person to whom this section applies shall be required to produce in any court or tribunal any book or document, or to divulge or communicate to any court or tribunal any matter or thing which that person may acquire or have access to or be given by way of information to which this section applies.

(5) The certificate referred to in subsection (3) shall be given in the form prescribed by the Commissioner, and shall include the full name, address, and signature of the person giving the certificate and the date on which the certificate is given.

(6) The certificate referred to in subsection (3) and subsection (5) shall,—

(a) where it is given by any persons referred to in paragraph (c) or paragraph (d) of subsection (2), be kept by the department for the time being responsible for the administration of the Social Security Act 1964 as a permanent record; and

(b) where it is given by any persons referred to in subsection (2)(db) or (e), be kept by the Ministry of Justice as a permanent record; or

(bb) if it is given by any persons referred to in subsection (2)(dc), be kept by the New Zealand Police as a permanent record; or

(c) where it is given by any other person referred to in subsection (2), be kept by the Inland Revenue Department as a permanent record.

(7) Every person to whom this section applies who knowingly acts in contravention of any provision of this section commits an offence against this section and is liable on conviction to imprisonment for a term not exceeding 6 months or to a fine not exceeding $15,000.

(8) Notwithstanding anything in any other Act, nothing shall prevent the Commissioner or any officer of the Inland Revenue Department from—

(a) using information obtained under this Act for the purposes of carrying into effect the provisions of any of the Inland Revenue Acts; or

(b) using information obtained under any of the Inland Revenue Acts for the purposes of carrying into effect the provisions of this Act.

(9) Sections 81 to 87 of the Tax Administration Act 1994 shall not prevent officers of the Inland Revenue Department from advising persons who potentially are liable persons of the amount of child support that is likely to be payable by that person, based on the income of that person.

(10) No obligation as to secrecy or other restriction upon the disclosure of information imposed by any enactment or otherwise shall prevent the chief executive of the department for the time being responsible for the administration of the Social Security Act 1964 or any officer of that department authorised in that behalf from disclosing to the Commissioner—

(a) information obtained for any purpose and which is required to be disclosed by the persons authorised by this subsection for the purposes of carrying into effect the provisions of this Act:

(b) information held in relation to any person who is required to make liable parent contributions assessed under the Social Security Act 1964:

(c) the name and address of any person who is in receipt of a benefit under the Social Security Act 1964 and who is a liable person or a payee under this Act.

(11) Information obtained pursuant to subsection (10) shall not be disclosed except—

(a) to the Commissioner or any officer of the Inland Revenue Department authorised in that behalf; or

(b) for the purposes of any proceeding connected with a matter in relation to which those persons so authorised perform their duties.

Tax Administration Act 1994

Section 6: Responsibility on Ministers and officials to protect integrity of tax system

(1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.

(2) Without limiting its meaning, **the integrity of the tax system** includes—

(a) taxpayer perceptions of that integrity; and

(b) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; and

(c) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and

(d) the responsibilities of taxpayers to comply with the law; and

(e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and

(f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

Section 6A: Commissioner of Inland Revenue

(1) The person appointed as chief executive of the department under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.

(2) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

(3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—

(a) the resources available to the Commissioner; and

(b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and

(c) the compliance costs incurred by taxpayers.

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 16/04: GOODS AND SERVICES TAX – GST TREATMENT OF PARTNERSHIP CAPITAL CONTRIBUTIONS

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. References to the PA are to the Partnership Act 1908.

This Question We've Been Asked is about ss 8 and 57.

Question

1. Is a GST registered partnership required to account for output tax on a capital contribution made by a partner?

Answer

2. No. If there is any supply of goods and services in return for the capital contribution, then it is a supply made by a partner or partners, not the partnership.
3. The transfer of a partnership interest by an existing partner is the supply of a service, namely a chose in action consisting of a fractional interest in the future profits of the partnership business and in any surplus of assets over liabilities on winding up.
4. Where a partnership capital contribution is made in return for the transfer of a partnership interest from an existing partner, the supply of the partnership interest is made by the existing partner. The partnership interest is not supplied by the partnership. The supply of a partnership interest by a partner is made in their capacity as a partner of the partnership.
5. However, not all partnership capital contributions will necessarily involve the supply of a partnership interest. Where there is no supply of a partnership interest, no supply of any goods and services is made by the partnership.
6. The deeming provisions in ss 57(2)(b) and 57(2)(c) do not apply to the supply of a partnership interest by a partner in consideration for partnership capital contributions. That is, the supply of a partnership interest by a partner in return for a capital contribution is not deemed to be made by the partnership for GST purposes. This is because the supply of the partnership interest will not have been made in the course of the partnership's taxable activity.
7. Consequently, no GST is charged by the partnership on the supply of a partnership interest that is transferred in return for a partnership capital contribution.

Explanation

Background

8. QB 14/03: "GST – transfer of interest in a partnership", published in *Tax Information Bulletin* Vol 26, No 5 (June 2014): 57, considered the transfer of partnership interests by individual partners, where any payment by the recipient was made to the individual partner(s) who transferred their interests. This item considers situations when a new or existing partner in a partnership contributes capital to the partnership, as opposed to transferring it to an individual partner.

Analysis

Introduction

9. For GST purposes, a "partnership" has the meaning set out in the Partnership Act 1908 (PA) (definition of "partnership" in s 2(1)). Under s 4(1) of the PA, a "partnership" is "the relation which subsists between persons carrying on a business in common with a view to profit". The nature of the relationship between the partners is contractual. That is, the partners have agreed to enter into a legally binding contractual relationship with each other (*Pooley v Driver* (1876) 5 Ch D 458 at 472). A partnership is not a legal entity separate from its partners (*Sadler v Whiteman* [1910] 1 KB 868 (CA) at 889; *R v Holden* [1912] 1 KB 483 (CA) at 487; *Meyer & Co v Faber* (No 2) [1923] 2 Ch 421 (CA); *Mephistopheles Debt Collection Service v Lotay* [1995] 1 BCLC 41 (CA)).
10. For GST purposes, a partnership is an "unincorporated body". Despite a partnership not being a separate legal entity under ordinary law, there are special GST rules in the Act in relation to unincorporated bodies, including partnerships. These are set out in s 57 and allow the unincorporated body to be registered when carrying on a taxable activity. For partnership capital contributions, only s 57(2) is of direct relevance.

11. Where a partnership carries on any taxable activity and is registered for GST purposes (preliminary words of s 57(2)):
    - the partnership shall be registered under the name of the partnership (s 57(2)(d));
    - the partners shall not be registered (or liable to be registered) in relation to the carrying on of that taxable activity (ie, the taxable activity carried on by the partnership) (s 57(2)(a));
    - the partnership is deemed to supply any goods and services supplied in the course of carrying on that taxable activity (and the partners are deemed not to have supplied them) (s 57(2)(b));
    - any goods and services supplied to, or acquired by, the partners (acting in their capacity as members of the partnership) in the course of carrying on that taxable activity, not being goods or services to which s 57(2)(b) applies, are deemed to be supplied to, or acquired by, the partnership (and are deemed not to be supplied to, or acquired by, the partners) (s 57(2)(c));
    - any change of members of the partnership has no effect for GST purposes (s 57(2)(e)).
12. For s 57(2) to apply to partnership capital contributions, the following questions need to be answered:
    - Is the partnership capital contribution consideration for a supply of goods and services? If it is, then:
      - Is the supply of goods and services made to, or acquired by, a partner acting in their capacity as a member of the partnership under s 57(2)(c)?
      - Is the supply made in the course of carrying on the partnership's taxable activity under s 57(2)(b) or s 57(2)(c)?
    - Is the partnership capital contribution ignored under s 57(2)(e) because it relates to a change of partners in the partnership?

Is the partnership capital contribution consideration for a supply of goods and services?

13. If there is a supply of goods and services when a partnership capital contribution is made, it will be a supply of a partnership interest. A partnership interest is a partner's share in the partnership property. It is the proportion of the partnership assets to which the partner would be entitled if the partnership was dissolved (*Re Bainbridge* (1878) 8 Ch D 218 at 223).
14. Richardson J described the nature of a partnership interest in *Hadlee and Sydney Bridge Nominees Ltd v CIR* (1991) 13 NZTC 8,116 (CA) at 8,126:

> **A share in a partnership is a chose in action.** It is a fractional interest in the future profits of the partnership business and in a surplus of assets over liabilities on a winding up. **The partner does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership** (*Lindley on Partnership* 15th ed, 516; *Maw v Maw* [1981] 1 NZLR 25). [Emphasis added]

15. In the same case at 8,118–8,119, Cooke P described the nature of a partnership interest in this way:

> As noted in this Court in *Maw v Maw* [1981] 1 NZLR 25, the expression "share in a partnership", which is commonly used and was used on the deed of assignment in the present case, is a somewhat loose one. **The true position, so far as now relevant, is that the partners have proprietary interests in equity in all the assets, including the gross income.** …
>
> **All these proprietary interests of partners are assignable in equity.** …
>
> … As between the assignor and a trustee to whom he has assigned his "share" in the partnership, the section [s 34(1) of the PA] in no way limits the effect of the assignment. The assignor has divested himself of the beneficial proprietary interest to the extent that he has assigned it, and there is no restriction on his power to do so.
>
> In this case the references in the deed of assignment to the share of the profits and to accounts on dissolution are expressed to be without limiting the generality of the absolute assignment of "the Property", being "... the percentage of the Partner's share in the partnership ... represented by the number of units specified in the Second Schedule ..." In equity the manifest intention is entitled, I think, to full effect. As to 12.8 of the units the assignor has deprived himself of any beneficial interest, whether in capital or in income. In equity the entire beneficial interest in that (undivided) 40 per cent of his share, including the same proportion of any gross partnership income as and when received, vests in the family trust. [Emphasis added]

16. Because a partnership interest is a chose in action, a supply of a partnership interest is a supply of services (definition of "services" in s 2(1)).
17. Under ordinary law, any supply of a partnership interest will necessarily be a supply made by a partner to another partner (either existing or new). The transfer of partnership interests is made by the partners because the partnership is a not a legal entity separate from the partners such that it could itself supply partnership interests.
18. In practical terms, a retiring partner may transfer their interest in the partnership to a new partner or when an additional partner joins the partnership, the existing partners must give up some of their partnership interests to the newcomer for that person to become a partner. A simple example would be

where the partners in a two person partnership invited a third person to become a partner. Previously the two partners each had a 50% partnership interest but now some of their interests are transferred to the third person.

19. This is consistent with the conclusions drawn in QB 14/03, where the payment by the recipient was made to the individual partner(s) who transferred their interests. Therefore, whether the payment by the incoming partner is made to an individual partner or partners, or is made as a partnership capital contribution, is irrelevant. In either case, any supply of a partnership interest will necessarily be a supply made by a partner to another partner (either existing or new).

20. However, not all partnership contributions will necessarily involve the supply of a partnership interest. For example, where the existing partners make contemporaneous capital contributions in proportion to their existing partnership interests (eg, two partners, each holding a 50% partnership interest, each contribute an additional $10,000), the partnership interest of each partner does not change. A second example relates to the capital contributions made by the partners of a newly created partnership. In this case, there are no existing partnership interests to be supplied. Rather, the partnership interests are created as a matter of law by the formation of the partnership. A third example relates to capital contributions made by existing partners where the default provisions of the PA apply (s 27(a) of the PA). Section 27(a) of the PA reads as follows:

> **27 Rules as to interests and duties of partners subject to special agreement**
>
> The interests of partners in the partnership property, and their rights and duties in relation to the partnership, shall be determined, subject to any agreement (express or implied) between the partners, by the following rules:
>
> (a) all the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses, whether of capital or otherwise, sustained by the firm:

21. Where the default provisions of the PA apply, the partnership interest of an existing partner who makes a capital contribution will remain unchanged. Consequently there will be no supply of a partnership interest.

Is the supply of the partnership interest made to, or acquired by, a partner acting in their capacity as a member of the partnership?

22. Even if there is a supply of a partnership interest by a partner or partners when a partnership capital contribution is made, s 57(2)(c) will only apply if the partner(s) made the supply in their capacity as a member of the body. "Member" is defined in s 2(1) as including "a partner". So, in other words, the supply must be made by the partner acting in their capacity as a partner.

23. The supply of a partnership interest involves the supply of a share of the partner's beneficial interest in the partnership assets (*Hadlee* at 8,126). Without the consent of the other partners, no partner may deal with partnership property. This is according to s 23(1) of the PA, which reads as follows:

> All property and rights and interests in property originally brought into the partnership stock, or acquired (whether by purchase or otherwise) on account of the firm or for the purposes and in the course of the partnership business, are called in this Act **partnership property**, and must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

24. This is consistent with the nature of the relationship between the partners, namely that they have agreed to enter into a legally binding contractual relationship with each other (*Pooley v Driver* at 472).

25. Therefore, a partner only has a partnership interest because of the partnership relationship. They cannot deal with it without the consent of the other partners. In this light, the Commissioner considers that a partner who transfers part or all of their partnership interest when a partnership capital contribution is made by another person will have made that supply in their capacity as a partner. The partner making the supply of their partnership interest could not be acting in any other capacity given the nature of what is supplied and the nature of the relationship with the other partners.

Is the supply of the partnership interest made in the course of carrying on the partnership's taxable activity?

26. Sections 57(2)(b) and 57(2)(c) will only apply when the supply is made by, or to, the partner "in the course of carrying on the taxable activity". This is a different test from the general supply test under s 8(1) which refers to supplies made "in the course or furtherance of a taxable activity". The phrase "in the course of" is not defined in the Act. The *Concise Oxford English*

Dictionary (12th ed, Oxford University Press, Oxford, 2011) defines the phrase "in the course of" as follows:

> **in (the) course of 1** undergoing (the specified process). **2** during (the specified period).

27. In *Public Trustee v Henderson & Pollard, Limited* [1956] NZLR 180 (Compensation Court), Dalglish J considered the meaning of "in the course of" in the context of the phrase "arising out of or in the course of the employment" as used in the Workers' Compensation Act 1922. At 184–185, he stated:

> In various cases, the Courts have framed tests which must be satisfied in order to bring an accident within the course of a worker's employment. Thus, in St Helen's *Colliery Co Ltd v Hewitson* [1924] AC 59; 16 BWCC 230, Lord Atkinson said: "**A workman is acting in the course of his employment** when he is engaged 'in doing something he was employed to do'. Or what is, in other and I think better words, in effect the same thing—namely, **when he is doing something in discharge of a duty to his employer, directly or indirectly, imposed upon him by his contract of service. The true ground upon which the test should be based is a duty to the employer arising out of the contract of employment, but it is to be borne in mind that the word 'employment' as here used covers and includes things belonging to or arising out of it**" (ibid 71; 238). This lastmentioned statement of the law was expressly approved in *Newton v Guest, Keen & Nettlefolds, Ltd* (1926) 19 BWCC 119, 125. [Emphasis added]

28. At 185–186, Dalglish J stated that "in the course of" an activity also includes "natural incidents" of that activity or things "necessarily incidental" to that activity.

29. At 185, Dalglish J rejected the view that "in the course of" was equivalent to "during". While something that occurred "in the course of" employment would occur during the time that someone was employed, something more was required. The event must have happened while the person was doing something that they were employed to do (or while doing something that was naturally or necessarily incidental to their employment). Consequently, the Commissioner considers that the second dictionary definition noted in [26] above, in the absence of something more, is not sufficient for a supply to have been made in the course of carrying on the partnership's taxable activity. Rather, as indicated in the first dictionary definition and in *Henderson & Pollard*, the supply must be made as part of carrying on the partnership's taxable activity while undergoing that taxable activity. That is, the supply must belong to or arise out of the taxable activity or it must be a natural or necessary incident of the taxable activity.

30. Examples of supplies made in the course of carrying on a taxable activity can be seen from the facts in *Case M129* (1990) 12 NZTC 2,839 at 2,845 and *Case S41* (1995) 17 NZTC 7,280. In *Case M129*, Judge Barber held that hiring staff was a "normal incident" of running a drapery taxable activity and was therefore undertaken in the course of that taxable activity. In *Case S41*, an agreement entered into by a professional partnership to lease office premises was in the course of the partnership's taxable activity.

31. As noted above, the phrase used in s 57(2) – "in the course of" – differs from the phrase commonly used in the Act, namely "in the course or furtherance of". The term "furtherance" is defined in the *Concise Oxford English Dictionary* as:

> **furtherance n**. the advancement of a scheme or interest.

32. In *Case N43* (1991) 13 NZTC 3,361, Judge Bathgate held that the purchase and relocation of dwellings on to land that was being subdivided and sold was in the furtherance of the taxpayer's taxable activity. This was because it was for the purpose of enhancing the sale prospects of the subdivided land. At 3,366, Judge Bathgate distinguished "in the furtherance of" from "in the course of":

> An act done for the purpose or object of furthering the taxable activity, or achieving its goal, can be to help, achieve, or advance, and thus a "furtherance" of a taxable activity, although it may not necessarily be always in the course of that taxable activity.

33. In summary then, something done in the course of a taxable activity will be something belonging to, or arising out of, that taxable activity. It will include anything that is a necessary or natural incident of the taxable activity. Where something is not done in the course of a taxable activity, it may nevertheless be in the furtherance of the taxable activity if it advances it or helps to achieve its goals.

34. Consistent with the use of the phrase "in the course of" in the Act, the Commissioner considers that a direct connection or nexus is needed between the supply of goods and services and the operation or carrying on of the taxable activity for the supply to have been made "in the course of" carrying on that activity. This is consistent with *Case S84* (1996) 17 NZTC 7,526 at 7,533 where Judge Barber stated that s 57(2) was intended to apply to "day to day supplies":

> … **in my view, s 57(2) was meant to apply to the day to day supplies to or from an unincorporated group by making it clear that, where members make or receive supplies, they are deemed to be doing so on behalf of the partnership**. I suggested that the aim of s 57(2) is to make

> it clear that where people operate an unincorporated body (eg a partnership), then they can register the body for GST purposes and do not need to register each member of it; and supplies (outputs) in the course of the body's activity, made by one or more members of the body (or their agents), are deemed made by the body and not by the member; similarly with inputs regarding supplies to a member of the body for the body. [Emphasis added]

35. On the basis of the above discussion, the Commissioner considers that Parliament deliberately chose to restrict the application of ss 57(2)(b) and 57(2)(c) to when the goods and services are supplied "in the course of carrying on [the partnership's] taxable activity". This means that these paragraphs will not apply to supplies of goods and services merely made in the furtherance of the partnership's taxable activity.

36. In the context of the supply of a partnership interest by a partner in return for a partnership capital contribution, the Commissioner considers that the supply of partnership interests relates to the ownership structure of the taxable activity, rather than to the operation or carrying on of the taxable activity. That the ownership structure is not directly related to the carrying on of the taxable activity can be seen from the fact that a different ownership structure would have no impact on the operation of the taxable activity. It could equally be carried on by a sole trader or by a company, for example. Therefore, the supply of a partnership interest will not be made in the course of the partnership's taxable activity.

Consequences

37. It has been concluded that:
    - The transfer of a partnership interest by an existing partner is the supply of a service, namely a chose in action consisting of a fractional interest in the future profits of the partnership business and in any surplus of assets over liabilities on winding up.
    - Where a partnership capital contribution is made in return for the transfer of a partnership interest from an existing partner, the supply of the partnership interest is made by the existing partner. The partnership interest is not supplied by the partnership. The supply of a partnership interest by a partner is made in their capacity as a partner of the partnership.
    - However, not all partnership capital contributions will necessarily involve the supply of a partnership interest. Where there is no supply of a partnership interest, no supply of any goods and services is made by the partnership.
    - The deeming provisions in ss 57(2)(b) and 57(2)(c) do not apply to the supply of a partnership interest by a partner in consideration for partnership capital contributions. That is, the supply of a partnership interest by a partner in return for a capital contribution is **not** deemed to be made by the partnership for GST purposes. This is because the supply of the partnership interest will not have been made in the course of the partnership's taxable activity.
    - Consequently, no GST is charged by the partnership on the supply of a partnership interest that is transferred in return for a partnership capital contribution.

38. Section 57(2)(a) states that the partners shall not be registered in relation to the carrying on of the partnership's taxable activity. Consequently, supplies of partnership interests by partners in return for a partnership capital contribution will only be subject to GST if one or more partners carry on a separate taxable activity that involves the supply of partnership interests (and that supply is not an exempt supply of a "participatory security" (discussed in detail in QB 14/03)).

39. These conclusions are consistent with those drawn in QB 14/03. That item considered the GST treatment of the transfer of a partnership interest from one partner to a new or existing partner where there was no consequent capital contribution to the partnership.

Is the partnership capital contribution ignored under s 57(2)(e) because it relates to a change of partners in the partnership?

40. Under s 57(2)(e), "any change of members" of a partnership has no effect for GST purposes. The supply of a partnership interest by a partner in return for a partnership capital contribution may involve a change in members, although this is not always the case. But even if there is a corresponding change in members, how s 57(2)(e) applies to the supply of partnership interests (if it applies at all) must be determined.

41. In this regard, unless the partner's taxable activity involves the supply of partnership interests (something that, although possible, would be out of the ordinary), it has been concluded that no GST is chargeable on the supply of a partnership interest in return for a partnership capital contribution.

42. The Commissioner has identified two possible interpretations of s 57(2)(e). The first is that the provision only determines that there are no GST

implications arising *from a change of members of a partnership*. That is, changing partners in itself does not give rise to any GST implications. This interpretation still means that a supply of a partnership interest by one partner to another could, potentially, be subject to GST if the right circumstances existed. In the discussion that follows, this is referred to as the "narrow approach".

43. Alternatively, a "wider approach" is to interpret the provision to mean that whenever there is a change in members of a partnership – which can only ever occur by virtue of one or more partners supplying their partnership interest to a new or existing partner – then there is no effect for GST purposes at all. Adopting this approach would mean that s 57(2)(e) applies to both the change in composition of the partnership **and** the mechanism by which that is achieved (ie, the supply of the partnership interest).

44. In the Commissioner's view, the reference to a change of members, rather than to changes of membership interests, indicates the intended scope of the provision. For GST purposes, a registered unincorporated body, including a partnership, is treated as continuing to be the same body despite a change of members. For example, if a partnership has 25 partners and two retire and one new partner joins, the change of members does not create a new unincorporated body for GST purposes. The partnership is treated as being the same registered person before and after the change of members. It is noted that a partnership that reduces to one partner (and, therefore, is no longer a partnership at general law) will also no longer be an "unincorporated body of persons" or a partnership for GST purposes.

45. This interpretation is consistent with the narrow approach outlined above that s 57(2)(e) is limited to ensuring the continuity of an unincorporated body. There is nothing to suggest that Parliament intended this paragraph to be interpreted more widely so that the supply of a partnership interest is not a supply for GST purposes. However, the supply will not be a taxable supply unless the partnership interest is supplied in the course or furtherance of a taxable activity carried on by the partner who makes the supply. As noted earlier, this would be possible but uncommon.

46. Therefore, s 57(2)(e) only appears to apply to the registration and cancellation of registration provisions. That is, s 57(2)(e) means that a partnership is not required to cancel its registration when its members change and then re-register the new partnership. This will reduce the compliance costs and GST recovery issues of a change in members.

Correct GST treatment of partnership capital contributions

47. Where a partnership capital contribution involves the transfer of a partnership interest from an existing partner, there will be a supply of services, namely a chose in action. However, not all partnership capital contributions will necessarily involve such a supply.

48. A partner who transfers part or all of their partnership interest when a partnership capital contribution is made by another person will have made that supply in their capacity as a partner. The Commissioner considers that the partner making the supply of their partnership interest could not be acting in any other capacity given the nature of the services supplied.

49. The deeming provisions in ss 57(2)(b) and 57(2)(c) do not apply to the supply of partnership interests by partners in consideration for partnership capital contributions. This is because the supply of a partnership interest will not be made in the course of the partnership's taxable activity.

50. The non-application of ss 57(2)(b) and 57(2)(c) means that the supply of a partnership interest by a partner in return for a partnership capital contribution is not deemed to be made by the partnership for GST purposes. Consequently, the supply of a partnership interest by a partner in return for a capital contribution will only be subject to GST if the *partner* is required to charge GST under s 8(1). Under s 57(2)(a), the partners shall not be registered in relation to the carrying on of the partnership's taxable activity. Therefore, the supply of a partnership interest by a partner in return for a partnership capital contribution will only be subject to GST if the partner carries on a separate taxable activity that involves the supply of partnership interests.

51. The Commissioner considers that s 57(2)(e) only applies to the registration and cancellation of registration provisions. That is, s 57(2)(e) means that a partnership is not required to cancel its registration when its members change and then re-register the new partnership.

References

Related rulings/statements
QWB 14/03: "GST – transfer of interest in a partnership" *Tax Information Bulletin* Vol 26, No 5 (June 2014): 57
Subject references
GST, imposition of tax, partnerships, capital contributions, transfer of partnership interests
Legislative references
Goods and Services Tax Act 1985: ss 2(1) (definitions of "member", "partner", "partnership", "services" and "unincorporated body"), 8 and 57 Partnership Act 1908: ss 4, 23 and 27
Case references
Case M129 (1990) 12 NZTC 2,839 *Case N43* (1991) 13 NZTC 3,361 *Case S41* (1995) 17 NZTC 7,280 *Case S84* (1996) 17 NZTC 7,526 *Hadlee and Sydney Bridge Nominees Ltd v CIR* (1991) 13 NZTC 8,116 (CA) *Meyer & Co v Faber* (No 2) [1923] 2 Ch 421 (CA) *Mephistopheles Debt Collection Service v Lotay* [1995] 1 BCLC 41 (CA) *Pooley v Driver* (1876) 5 Ch D 458 *Public Trustee v Henderson & Pollard, Limited* [1956] NZLR 180 (Compensation Court) *R v Holden* [1912] 1 KB 483 (CA) *Sadler v Whiteman* [1910] 1 KB 868 (CA)

ITEMS OF INTEREST

WITHDRAWAL OF STANDARD PRACTICE STATEMENT GNL-170: RELEASE OF INFORMATION

Standard practice statement ("SPS") GNL-170 issued September 2001 and published in *Tax Information Bulletin* Volume 13, Number 9 has been withdrawn, effective immediately.

SPS GNL-170 was issued to provide guidelines on how Inland Revenue would handle requests for information made under the Official Information Act 1982 ("OIA") and the Privacy Act 1993 ("PA").

A review of SPS GNL-170 has concluded the SPS no longer reflects the Commissioner's approach to considering OIA and PA information requests. The Inland Revenue website **www.ird.govt.nz** will be updated to provide further information to customers on how they may send OIA and PA requests to Inland Revenue.

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 "EASILY SATISFIED" THAT THE COMMISSIONER'S ASSESSMENT WAS AN HONEST APPRAISAL AND A GENUINE EXERCISE OF JUDGEMENT

Case	Musuku v Commissioner of Inland Revenue [2016] NZHC 934
Decision date	10 May 2016
Act(s)	Tax Administration Act 1994, Income Tax Act 2004
Keywords	Honest appraisal, Genuine exercise of judgement, Dividend income, Employment income, Income under ordinary concepts

Summary

The High Court dismissed Mr Musuku's appeal and upheld the Commissioner of Inland Revenue's ("Commissioner's") assessment as an honest appraisal and genuine exercise of judgement. Justice Moore agreed with the Taxation Review Authority ("TRA") that the amounts assessed were dividend income under s CD 1 of the Income Tax Act 2004 ("Act"), employment income under s CE 1 of the Act or income under ordinary concepts under s CA 1 of the Act.

Facts

Mr Musuku ("the appellant") was a director and shareholder of three pharmacy owning companies which employed him as a pharmacist. The appellant was also the trustee of the Musuku Family Trust ("Trust") and a director and shareholder of another closely held company.

At the time the Commissioner commenced her review of the appellant's tax affairs, the appellant had not filed a tax return for six years, two of his companies had failed to submit goods and service tax returns since incorporation, one of his companies had last filed an income tax return three tax years prior and the Trust and one of his companies did not have an IRD number and had not filed any returns.

The Commissioner's investigation occupied some seven years. Finally, in the face of the appellant's effective refusal to co-operate, the Commissioner made a default income tax assessment for the 2006 tax year. The resulting disputes phase was also protracted. The Disputes Review Unit upheld the Commissioner's statement of position in late July 2013 and an amended assessment was made on the basis that amounts deposited into various business and personal bank accounts to which the appellant had access and that were spent on his behalf and to his private benefit or were made available to him, was his taxable income as dividend income, employment income or income under ordinary concepts.

The TRA delivered a reserved decision on 27 July 2015 confirming that the appellant had not discharged the onus on him to prove on the balance of probabilities that (a) the amended assessment (and/or default assessment) was arbitrary and not a genuine attempt by the Commissioner to assess the appellant's taxable income and/or (b) the amended assessment was incorrect and, if so, by how much.

The appeal proceeded by way of a re-hearing.

Decision

Did the Commissioner fail to issue a proper assessment?

The appellant made three claims. Firstly, that the default and amended assessments were arbitrary. Secondly, that the assessments were not made on a credible or reasonable basis. Thirdly, that the assessments did not fully apply known facts and law.

Justice Moore held that on the evidence it was apparent that the Commissioner went to considerable lengths to ascertain the appellant's correct tax position and exhibited commendable patience in the face of a wide range of frustrations and difficulties in completing the enquiry in a timely way.

His Honour held that he was easily satisfied that the Commissioner's amended assessment and earlier default assessment were, in each case, an honest appraisal of the appellant's tax position and a genuine exercise of judgement.

Was the Commissioner's assessment incorrect?

Dividend income

Justice Moore found that the appellant had received amounts into his joint bank account from his companies which he retained and used for his private benefit. Furthermore, his Honour found that the appellant had received the benefit of amounts spent by his companies for his private benefit.

His Honour was satisfied that the transfers of value from the companies would not have been made but for the appellant's shareholding. Furthermore, his Honour held that no reliable or credible evidence of loans or drawings existed and the information provided with the appellant's notice of proposed adjustment (including the schedule of current accounts) appeared to have been created in an attempt to retrospectively justify the appellant's position, namely that the amounts were drawings and not dividends.

His Honour held that the appellant could be taken to have derived as dividend income under s CD 1 of the Act an amount equal to the private expenditure.

Employment income

Justice Moore agreed with the Commissioner that s CE 1(1)(g) of the Act casts a wide net to include in a person's employment income a cash amount derived that has a connection with their employment or service, even if that amount falls outside of the specific categories in s CE 1 of the Act.

His Honour held that to the extent the funds the companies made available to him were not dividends they would be his employment income under s CE 1 of the Act. In reaching this conclusion Justice Moore referred to the appellant's income protection insurance and the appellant's $19,000 declared salary which was not commensurate with the work undertaken by him.

Income under ordinary concepts

Justice Moore was also satisfied that if the amounts were not dividend income or income received as an employee then it would be income under ordinary concepts under s CA 1 of the Act.

Rent payments

Furthermore, his Honour was satisfied that rent payments made into the joint account of the appellant and his wife were income to the appellant under ordinary concepts.

Appeal dismissed and costs awarded

The appellant's appeal was dismissed and costs were awarded in favour of the Commissioner on a category 3 basis.

TRA STRIKES OUT TAXPAYER'S LATE CLAIM

Case	TRA 029/15 [2016] NZTRA 05
Decision date	16 May 2016
Act(s)	Rule 15 District Court Rules 2014 and Part 8A Tax Administration Act 1994
Keywords	Strike out, exceptional circumstances

Summary

The Commissioner of Inland Revenue ("the Commissioner") applied to strike out the disputant's belatedly filed notice of claim. The disputant filed a response which the Taxation Review Authority ("the TRA") accepted as an application to allow proceedings to be commenced out of time. The TRA determined (on the papers) that there were no exceptional circumstances, consequently dismissing the disputant's application, and granted the Commissioner's application to strike out the proceedings.

Impact

The decision reinforces the importance of complying with the strict procedures for the commencement of challenge proceedings in the TRA as outlined in the Tax Administration Act 1994 ("TAA").

Facts

The disputant owns a residential property and claimed rental losses in relation to the property in the 2006, 2007 and 2009 to 2012 income years.

The Commissioner made reassessments for the 2009 to 2012 income years after two separate audits of the disputant's income tax returns.

The disputant served a Notice of Proposed Adjustment ("NOPA") on the Commissioner on or about 12 November 2014 seeking an adjustment of $18,087. The NOPA was rejected by the Commissioner and the Disputes Review Unit subsequently decided that the adjustment proposed by the disputant should not be made.

The Notice of Final Decision dated 30 June 2015 and a copy of the adjudication report were sent to the disputant including information regarding the specific procedure to be followed if the disputant wished to challenge the assessment.

The investigator responsible for the audits of the disputant's tax returns ('Ms A') spoke with the disputant on several occasions in August 2015 regarding bringing challenge proceedings and the procedure to do so.

Ms A received a handwritten document on 27 August 2015 from the disputant titled "Notice of Claim" which had been sent to the Commissioner's office in Wellington. Ms A subsequently followed up with the disputant reminding her of the procedure to bring a challenge and the dates by which to do so.

On 8 September 2015, Ms A received a second document purporting to be the disputant's notice of claim. Ms A then contacted the Litigation Management Unit ("LMU") which confirmed the document had not been filed in the TRA as required.

Mr X, a solicitor with LMU, contacted the disputant by phone and email on 9 September 2015 regarding the procedure and timeline for commencing a challenge in the TRA. He spoke to the disputant again on 18 September 2015 and recommended that she file a notice of claim as soon as possible.

On 24 September 2015, the disputant filed a notice of claim with the TRA.

The Commissioner applied to strike-out the disputant's challenge proceedings on the grounds that the proceedings were filed out of time and no application had been made for an extension of time.

The disputant filed a response which the TRA accepted as an application to allow proceedings to be commenced out of time under s 138D of the TAA. Additionally, the disputant was given further opportunity to file affidavit evidence in response to the Commissioner's application, as well as being urged by the TRA to seek legal advice.

Decision

The TRA was satisfied that the disputant's failure to file her challenge within the required time period in accordance with s 138B(3)(c) of the TAA came about because the disputant did not follow the procedure for bringing a challenge and not because of any event or circumstance which was beyond her control.

Therefore the TRA concluded that no exceptional circumstances existed and accordingly dismissed the disputant's application to allow the challenge proceedings to be commenced out of time.

Having decided that the disputant had failed to comply with s 138B of the TAA, the TRA applied the decision in *Allen v Commissioner of Inland Revenue* ([2006] 3 NZLR 1, (2005) 22 NZTC 19,473 (CA) at [41]) and concluded that it did not have jurisdiction to hear the claim and that it must strike out the challenge proceedings under s 138H of the TAA.

AUTHORITY CONCLUDES NOTICE OF ASSESSMENT CORRECTLY GIVEN BUT FINDS EXCEPTIONAL CIRCUMSTANCES UNDER S 89K

Case	TRA 020/15
Decision date	5 May 2016
Act(s)	Tax Administration Act 1994 ss 14, 89K, 111
Keywords	Notice of assessment, notice of proposed adjustment, s 89K, exceptional circumstances, as soon as reasonably practicable, last known address, China

Summary

This case concerned two separate issues: first, when did the Commissioner of Inland Revenue ("the Commissioner") give notice of an assessment such that dispute rights commenced, and secondly, whether the Commissioner's decision to refuse to accept out of time a notice of proposed assessment ("NOPA") was correct. The Taxation Review Authority ("the Authority") held that notice was given when the Commissioner issued a notice of assessment to the taxpayer at its last known address. However, her decision to refuse to accept the late NOPA was incorrect as there were exceptional circumstances.

Impact

In relation to obligations under s 14 of the Tax Administration Act 1994 ("TAA"), the Judge adopted the *Aitken (Chief Executive, Ministry of Fisheries v Peter Aitken and Anor 2009* Wellington Registry CIV-2005-485-001947) case, which means that the Commissioner need not make any enquiry as to a taxpayer's correct address and is able to give notice by sending it to the last known address.

Judge Sinclair's analysis of what constitutes notice of an assessment makes it clear that, while in some cases documents may be combined to form notice of an assessment, on these facts the claimed documents could not be read together to form notice of the assessment.

The judgment also provides some guidance on the application of s 89K of the TAA, although this guidance is specific to the facts in this case.

Facts

This decision concerns preliminary issues that were required to be determined prior to any hearing on the substantive tax issues.

The disputant (trustees of a trust) claimed a goods and services tax ("GST") refund which, following audit by the Commissioner, was reassessed to nil. The disputant contends that the Commissioner gave notice of the (re) assessment in a letter dated 23 January 2013, to which the disputant purported to issue a NOPA on 19 February 2013. No notice of response ("NOR") was issued by the Commissioner and the disputant claimed that the NOPA is deemed accepted and the Commissioner is liable to pay the refund claimed.

The Commissioner denies that the letter of 23 January 2013 was a notice of assessment and says the notice of assessment was given under cover of a letter dated 16 April 2013. The disputant says that notice was not given in accordance with s 14 of the TAA until a copy was included with a letter from the Commissioner dated 5 March 2015. The disputant then issued a second NOPA dated 30 March 2015, along with an application under s 89K of the TAA for that NOPA to be accepted out of time on the basis of exceptional circumstances. The Commissioner declined the application to accept the second NOPA out of time.

Decision

When did the Commissioner give notice of the assessment for the GST period ended 31 October 2008 so that dispute rights commenced?

Judge Sinclair concluded that notice of the assessment was given under cover of the Commissioner's letter dated 16 April 2013, and the letter of 23 January 2013 was not a notice of assessment. Accordingly, the purported NOPA dated 19 February 2013 was not valid and the Commissioner was under no obligation to have issued a NOR.

In May 2010 Mr S (whom the Commissioner understood to be the trustee of the trust) moved to China. In December 2010 he asked Inland Revenue to send any mail to a Chinese postal address. He also included an email address and a Chinese mobile number.

In July 2011 Mr S signed and filed a form headed "Elect someone to act on your behalf" appointing a trustee company to act on behalf of the disputant in its dealings with Inland Revenue. The form had an expiry date of 1 January 2020.

In December 2012 the Commissioner received a letter from Mr B, as trustee of the disputant, requesting payment of the GST refund given four years had passed since the GST return was filed. The Commissioner replied to Mr B on 23 January 2013 advising that the GST period referred to had been reassessed in December 2010, the trustee at the time had been advised, and that no refund was available.

The disputant claimed that the December 2012 and January 2013 letters, when read together, contained sufficient information to constitute notice of the assessment.

The Commissioner argued that the January 2013 letter did not have the characteristics of a notice of assessment as (1) it did not purport to be a notice of assessment and did not use those words; (2) it did not contain any particulars of the assessment, such as the tax periods, amount or extent of the assessment; (3) it asserted that the reassessment occurred over two years previously and had been notified accordingly; and (4) it asserted that no refund was available.

The TRA noted that no particular form is prescribed by which the Commissioner is required to give notice of an assessment to a taxpayer pursuant to s 111, that in some cases documents may be combined to form an assessment, and that each case will depend on its facts.

The TRA was satisfied that the January 2013 letter did not constitute a notice of assessment for the purposes of s 111 of the TAA. It was clearly written to answer the matters raised in the December 2012 letter, was not intended to be a notice of assessment and did not include the information expected to be contained in a notice of assessment. The TRA noted that the notice of assessment triggers dispute rights and is an important document in the disputes procedure.

It was accepted by all parties that the notice accompanying the letter of 16 April 2013 was a notice of assessment for the purposes of s 111 of the TAA, but what was at issue was whether the notice was given in accordance with s 14 of the TAA. The Commissioner posted the notice of assessment to the Chinese address provided by Mr S in December 2010. The Judge found there was no evidence that Mr S ever told the Commissioner not to use the Chinese postal address.

Judge Sinclair adopted the approach in *Chief Executive, Ministry of Fisheries v Peter Aitken and Anor* (2009 Wellington Registry CIV-2005-485-001947) that there was no obligation on the Commissioner to establish the correct address for the disputant, and that she was entitled to use the disputant's last advised postal address.

Was the Commissioner's decision under s 89K of the TAA to refuse to accept out of time a NOPA dated 30 March 2015 correct?

Judge Sinclair concluded that the Commissioner's decision under s 89K to refuse to accept the second NOPA out of time was incorrect and set it aside.

Section 89K(1) provides that the Commissioner may accept a late NOPA where (a) the Commissioner considers that an exceptional circumstance has prevented a disputant from issuing a NOPA; and (b) the NOPA is sent as soon as reasonably practicable after becoming aware of their failure to issue a NOPA within the response period.

Judge Sinclair concluded that there were exceptional circumstances in this case, that the disputant acted reasonably, and that events were a consequence of the following decisions and actions taken by the Commissioner:

1) Although aware of the nomination of the trustee company to act on behalf of the disputant, the Commissioner did not act on this but asked Mr S to confirm that Mr A B (director of the trustee company, who had replaced Mr B as director after Mr B's bankruptcy) continued to have authority to act on behalf of the disputant. In the Judge's opinion, this overlooked that the nomination had been given to the trustee company;
2) Inland Revenue knew Mr S was resident in China. He gave an email address as his contact address and during a telephone conversation gave authority to send correspondence by email. Although some correspondence was sent by email, the Commissioner did not ask Mr S to sign the email consent form, and the notice of assessment was sent to the disputant by post only;
3) Despite giving 28 days for reply to questions, the Commissioner issued the notice of assessment before this period expired. The Judge considered that the disputant was entitled to expect that the specified time would be available for reply before the Commissioner took further action;
4) The disputant was not expecting the service of the notice;
5) Correspondence sent in response to Mr B's December 2012 letter was addressed to an incorrect post office box number;
6) The Commissioner did not take any action after documents were received on 7 May 2013 which showed that Mr S had retired as trustee some months earlier and that Mr B had been appointed trustee.

The TRA concluded that the disputant had met the second limb of the test (i.e. issuing the NOPA as soon as reasonably practicable). When asked by the disputant in November 2014 to pay the GST refund, the Commissioner replied that a notice of assessment had been issued in April 2013, although the Commissioner did not attach a copy of the notice of assessment to her letter. The disputant wrote again in November 2014, which was not replied to until 5 March 2015, this time attaching a copy of the notice of assessment. The disputant then issued a NOPA on 30 March 2015 and made an application under s 89K of the TAA. Judge Sinclair considered that the disputant had responded as soon as reasonably practicable after becoming aware of the giving of the notice of assessment, which was following receipt of the Commissioner's letter of 5 March 2015 and a copy of the notice of assessment.

HIGH COURT CONSIDERS A RIGHT TO USE LAND IN CONTEXT OF DEPRECIABLE INTANGIBLE PROPERTY

Case	ANZCO Foods Limited v Commissioner of Inland Revenue [2016] NZHC 1015
Decision date	18 May 2016
Act(s)	Income Tax Act 2007
Keywords	Depreciable Intangible Property, capital, right to use land

Summary

This case concerned an interest obtained under a settlement deed which amended an encumbrance over the taxpayer's land. The High Court rejected the taxpayer's argument that this interest was a right to use land pursuant to sch 14 of the Income Tax Act 2007 ("ITA") and was deductible as depreciable intangible property.

Impact

The decision is useful guidance in considering whether a deduction can be allowed in respect of depreciable intangible property. Although the case only concerns a "right to use land" as listed in sch 14, the principles are applicable to depreciable intangible property generally.

Facts

This is a tax challenge by ANZCO Foods Limited ("ANZCO"), seeking to challenge assessments by the Commissioner of Inland Revenue ("the Commissioner") disallowing deductions claimed for depreciation. The deductions were based on a payment to allow ANZCO to undertake meat processing and freezing activities at a plant previously owned by a rival meat processing company, AFFCO New Zealand Limited ("AFFCO").

The payment arose from a negotiated settlement to vary an encumbrance on land purchased by ANZCO. This encumbrance restricted ANZCO from using the land to slaughter, freeze, cool, and further process meat products. ANZCO treated the result of settlement with AFFCO as conferring upon it a right to use land and sought to depreciate that item under the ITA.

AFFCO closed and sold off a number of its properties during the 1990s. One of the properties, a meat processing plant located in Waitara, was sold to a third party and included an encumbrance/limitation in the sale and purchase agreement.

This encumbrance stated that the purchaser will not use the property for "slaughtering, processing, cooling or freezing of lamb, sheep, Bobby calves, cattle or goats for a period of twenty (20) years from the possession date". The sale and purchase agreement required the third party purchaser to secure the performance of this covenant by the purchaser and its successors in title.

ANZCO purchased the Waitara property from the third party in February 2004. ANZCO did not consider that its activities at the plant were caught under the encumbrance. AFFCO disagreed and issued proceedings seeking an injunction to prevent the land being used for the purpose of processing or manufacturing meat products.

AFFCO was successful in their proceedings in the High Court (*AFFCO New Zealand Ltd v ANZCO Foods Waitara Ltd* HC Wellington CIV-2004-985-499, 23 August 2004) and partially successful in the Court of Appeal (*ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA)). ANZCO applied for leave to appeal to the Supreme Court; however, a settlement was reached in July 2005 whereby ANZCO agreed to pay $5,600,000 plus GST to use the property and the words "further processing, cooling or freezing" were deleted from the terms of the encumbrance.

ANZCO treated the agreement as constituting the purchase of a "right to use" land under sch 14 of the ITA which was then spread as a deduction under s EA 3 ITA.

The Commissioner disagreed that the payment made by ANZCO to AFFCO under the settlement deed was depreciable intangible property and disallowed the deduction.

ANZCO'S position

ANZCO submitted it acquired a chose in action which was an item of intangible property. Further, this was an item of depreciable property as described in sections EE 6 to EE 8 of the ITA and the rights or interests it acquired from the settlement also fell within the definition of depreciable intangible property in s EE 62 of the ITA. The right to use land is listed as an item of depreciable property in sch 14 of the ITA and this is what ANZCO contend they receive under the settlement.

The Commissioner's position

The Commissioner submitted that all ANZCO secured as a result of the settlement was its release from the restriction on the use of its own property. The removal of the encumbrance reinstated rights that attached to its ownership of the land. In so doing the capital value of the land was enhanced. The value of the rights obtained would not depreciate over subsequent years. The payment made by ANZCO was therefore capital in nature and not capable of being the subject of any deduction.

The Commissioner argued the interest obtained by ANZCO was not a right to use land within sch 14. Furthermore, ANZCO obtained reinstated rights of ownership that do not decline in value as required by s EE 6(1) ITA and also the rights did not constitute separate "property" distinct from the ownership of the land.

Decision

What did ANZCO obtain as a result of its settlement with AFFCO?

Mander J considered that on the face of it a "right to use" the Waitara property was granted by the settlement deed. However, having considered the case law on this point (*Mills v Dowdall* [1983] NZLR 154 (CA) at 159; *Re Securitibank Ltd* (No 2) [1978] 2 NZLR 136 (CA); *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 and *Buckley & Young Ltd v Commissioner of Inland Revenue* [1978] 2 NZLR 485 (CA)), he concluded that "right to use" descriptor used in the terms of the contract cannot by itself be determinative. Rather, it is the legal character of the transaction that is actually entered into and the legal steps which are followed which are decisive.

The legal character of the transaction is to be ascertained by careful consideration of the contractual arrangements entered into. AFFCO did not hold or own any rights to use the Waitara property. The restriction contained in the original 1999 sale and purchase agreement did not equate to any retention by AFFCO of a right to use the property in any way. Rather, the covenant was negative in nature, restricting the use to which the Waitara property could be put.

Mander J considered the Court of Appeal's analysis from the earlier *ANZCO v AFFCO* litigation confirmed that when AFFCO entered into the sale and purchase agreement with the third party in 1999, it did not retain any subset of rights attaching to the fee simple estate. What rights acquired to prevent the use of the land for certain purposes were distinct from that bundle of rights and in particular from the right to use the land.

His Honour considered that the amendment of the encumbrance by removing a restriction on existing rights which formed part of the fee simple estate held by ANZCO was not to be equated with a conveyance or grant of rights held or enjoyed by AFFCO. Underscoring this finding is the fact the restriction was limited to a finite period after which the covenant expired. Upon that event triggering, no "right to use land" passed to the land owner, rather the contractual restriction (the "chose in action") secured by the encumbrance would extinguish.

His Honour identified an inconsistency with ANZCO's argument that it held intangible property, being a "chose in action". This was because in the hands of the owner of the land, the chose in action upon which the claim for depreciation is dependent no longer exists. The property owner's rights are no longer encumbered and the chose in action, the right to enforce that aspect of the contract, evaporates. The intangible property of the type contended for by ANZCO therefore only exists as a separate item of property in the hands of AFFCO or another third party.

Mander J concluded that what ANZCO obtained from the settlement was not a "right to use land" but the removal of a contractual restriction over its existing rights of use.

Did what ANZCO obtain constitute intangible depreciable property under the Act?

Was a "right to use land" as that term is to be interpreted in schedule 14 of the ITA acquired by ANZCO as a result of the settlement?

Schedule 14 of the ITA lists "the right to use land" as an item of depreciable intangible property. ANZCO argued this term should bear its plain and natural meaning and this is what they obtained under the settlement. The Commissioner argued the rights or interests acquired did not fall within the Schedule.

Mander J, noting principles relevant to the interpretation of tax statutes, went on to consider sch 14 in the immediate and general legislative context. His Honour also cited the *Simkin Trust cases (Trustees of the Simkin Trust v Commisioner of Inland Revenue* [2003] 2 NZLR 315 (CA) and *Trustees in the CB Simkin Trust v Commissioner of Inland Revenue* [2004] UKPC 55, (2005) 22 NZTC 19,001) which provide a detailed analysis of (what is now) sch 14. One of the principles emerging from this was that sch 14 must be interpreted consistently with the criterion that the property must have a finite useful life and that it would in normal circumstances be expected to decline in value over time.

His Honour considered that requirement may be viewed as an amalgam of the criterion in s EE 62(2)(b) and the qualifying description of depreciable property in s EE 6(1), but that ultimately the effect is the same; intangible depreciable property cannot include property that does not have a limited useful life. Mander J went on to conclude that the rights obtained by ANZCO were the reinstated rights of ownership and did not have a finite life span.

Was the "right to use land" depreciable property under section EE 6(1) of the ITA?

Mander J considered that even if he were to proceed on the basis the interest or right conveyed under the settlement deed was capable of constituting a right to use land under sch 14, ANZCO must still satisfy the requirement of s EE 6(3)(b) that the intangible property was depreciable property under subs (1). In order to be depreciable, the item of intangible property must be property that in normal circumstances might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for such purpose.

Mander J found that it was apparent that ANZCO was unable to satisfy the test because what was conveyed to ANZCO under the settlement deed was the restoration of inherent rights of ownership. The encumbrance held by AFFCO was for a limited period. However, once that period expired, ANZCO's full ownership rights would revive in perpetuity. ANZCO effectively bought out the restriction which prevented the use of its ownership rights which in normal circumstances would not be expected to decline in value. The reinstated rights of ANZCO to undertake further processing, cooling and freezing at the Waitara plant would continue to run with its ownership.

It was important to draw a distinction between what AFFCO held and what ANZCO received. The worth of the restrictive covenant declined over time, but it does not follow the value of the right to use the land reduced. ANZCO argued that what was conveyed to it was a right to use land but it relied on the value of the restriction on its use of the land in the hands of a competitor to meet the statutory requirement that the intangible property depreciated over time. This highlighted that what ANZCO acquired as a result of the settlement was not a right to use land but the discharge of a limitation over a right it already held as the owner of the fee simple state.

Conclusion

Mander J concluded that what ANZCO obtained pursuant to the settlement deed was a variation of the encumbrance which secured a contractual restriction on the landowner's rights of ownership. AFFCO had no actual right to use the Waitara land to convey to ANZCO.

His Honour considered that the meaning of a "right to use land" as listed in sch 14 as depreciable intangible property does not extend to include rights which form part of the ownership of the fee simple estate. The rights to use the land which became available to ANZCO as a result of the settlement do not have finite useful life over which they will depreciate. As a consequence, the payment made by ANZCO to obtain the variation of the encumbrance in order to access those rights reflects the increased capital value of the property in the hands of the owner.

While the value of the restriction in AFFCO's hands as a competitor of ANZCO reduced as the period of the covenant diminished, the value of the rights to use the land which were restricted by the covenant would not diminish over time in the hands of the landowner. There could be no expectation that such property rights would decline in value while being used to derive assessable income. In the absence of the value of the rights to use the land declining, such intangible property does not qualify as depreciable property under the Act.

Although the settlement deed may describe the transaction in terms of AFFCO granting to ANZCO the right to use the Waitara property in a particular way, the true contractual nature of the settlement was that the ambit of the encumbrance was simply reduced. At that point there was no basis upon which the previously encumbered rights could reasonably be expected to decline in value.

CONVICTIONS FOR OFFENCES UNDER THE TAA DO NOT DISQUALIFY INDIVIDUALS FROM ACTING AS LIQUIDATORS UNDER THE COMPANIES ACT 1993

Case	The Commissioner of Inland Revenue v Imran Mohammed Kamal [2016] NZHC 1053
Decision date	19 May 2016
Act(s)	The Companies Act 1993
Keywords	Application seeking prohibition order, Court jurisdiction in respect of former liquidators, strike-out

Summary

The High Court struck out two proceedings brought by the Commissioner of Inland Revenue ("the Commissioner") seeking orders prohibiting an individual from acting as a liquidator for up to five years. The Court found it could not overcome the fact that convictions under the Revenue Acts are not expressly included within the disqualifying criteria set out in s 280 of the Companies Act 1993 ("the Act"). The Court also found that the Act does not impose any general 'fit person" requirement on potential liquidators and that resignation as liquidator prior to the proceedings being brought ended any supervisory powers the Court may have had in respect of orders under s 286 of the Act.

Impact

The decision confirms that unless an individual falls within any of the express categories set out in s 280 of the Act, they will not be disqualified from acting as a liquidator. The decision also confirms there is no general "fit person" requirement for potential liquidators and the Court does not appear to have jurisdiction to make s 286 orders in relation to liquidators who resign prior to proceedings commencing.

Facts

From 17 October 2005 Mr Kamal and his company Accountants First Limited ("AFL") were on the Commissioner's list of approved tax agents.

On 15 February 2013 Mr Kamal, having pleaded guilty to six charges under the Tax Administration Act ("the TAA") of aiding and abetting AFL in providing false income tax and GST returns, and in providing misleading information to the Commissioner by way of altered tax invoices, was sentenced to three months' home detention and 150 hours of community work.

On 19 February 2014, the Commissioner sought to remove AFL from the list of approved tax agents. Mr Kamal unsuccessfully sought judicial review of that decision.

The Commissioner was a creditor of two companies, Hillman Ltd ("Hillman") and GDZ Services Ltd ("GDZ") which were both put into liquidation by shareholder resolution in 2014. In both instances the liquidator appointed was Mr Kamal who, through AFL, had continuing business relationships with two other companies involving some of the same directors and shareholders of the companies in liquidation.

In each liquidation Mr Kamal issued a Liquidator's First Report noting that he proposed to dispense with a meeting of creditors pursuant to s 245 of the Act. In each instance the Commissioner gave notice she required that a creditor's meeting be called (with a view to appointing replacement liquidators) and in each instance Mr Kamal failed to comply. The Commissioner subsequently sent Notices of Failure to Comply with Liquidator's Duties inviting a response as to how the failure would be remedied and that any failure to rectify would result in legal action to compel compliance. Mr Kamal declined to hold creditors' meetings.

The Commissioner served notices on Mr Kamal under s 286(2) of the Act requiring him to resign as liquidator and provide a written undertaking that he would not accept appointments as liquidator of any company for five years from that date. Mr Kamal resigned as liquidator but declined to give any such undertaking.

The Commissioner sought to have Mr Kamal prohibited from acting as a liquidator on the basis that he was unfit to accept appointment, or act, as liquidator. Mr Kamal pleaded that he resigned as liquidator before the Commissioner commenced the proceedings and there is no basis for the prohibition order the Commissioner now seeks. Mr Kamal applied to strike out portions of the Commissioner's statements of claim.

Decision

The Court struck out the entirety of both the Hillman and GDZ proceedings.

Was it reasonably arguable for the Commissioner that any general unfitness of Mr Kamal to accept appointment, or act as, liquidator amounted to a failure to comply with a "duty" as defined in s 285 of the Act? (Issue 1)

The Court noted that s 280 (which sets out a list of circumstances which disqualify someone from accepting appointment as a liquidator) does not include in the list conviction for offences involving dishonesty under the TAA. The Court did not accept the Commissioner's submission that the list in s 280 is not exhaustive.

The Court found that the references to s 280 in s 286(4) suggest that the power to remove a liquidator under s 286(4) is limited to the particular circumstances which are identified, in s 280, as disqualifying circumstances and that if there were a broader disqualifying ground of "unfit for appointment as liquidator generally", it is difficult to see why Parliament would have limited the relevant part of s 286(4) to disqualification under s 280.

The Court found that the Act does not impose any general requirement of fitness on liquidators, and it would be beyond the Court's function to add an overarching "fitness" requirement to the detailed list of disqualifying circumstances which Parliament has prescribed in s 280.

The Court held that there was no continuing failure by Mr Kamal to comply with a general duty to be a fit person to accept appointment as or to act as liquidator at the time the Commissioner commenced these proceedings.

If the answer to Issue 1 was "yes", was it reasonably arguable for the Commissioner that Mr Kamal was guilty of a continuing breach of that duty at the time these proceedings were commenced? (Issue 2)

Given the conclusion reached on Issue 1, the Court did not find it necessary to examine Issue 2.

Was it reasonably arguable for the Commissioner that, at the time these proceedings were commenced, there was a continuing failure by Mr Kamal to comply with duties to disqualify himself from appointment as liquidator of Hillman and/or GDZ on account of his alleged continuing business relationships with directors of those companies and to convene meetings of the creditors of Hillman and/or GDZ? (Issue 3)

The Court considered that while Mr Kamal's respective resignations as liquidator of Hillman and GDZ may not have had the effect of curing the breaches relied upon by the Commissioner, they did have the effect of eliminating any continuing failure to comply with the relevant duties. The Court found that once Mr Kamal had resigned he was no longer bound by the duties on which the Commissioner was relying to seek the prohibition orders sought.

The Court took the view that Mr Kamal was no longer bound by the relevant Companies Act duties when he resigned and that s 284(2) could not be called upon to try and overcome the plain words of s 286(2).

If it was reasonably arguable for the Commissioner that when these proceedings were issued Mr Kamal was guilty of a continuing failure to comply with a relevant duty or duties, was it also reasonably arguable for the Commissioner that the seriousness or persistence of the failure or failures was such as to make Mr Kamal unfit to act as a liquidator? (Issue 4)

Given the conclusion on Issue 3, the Court did not find it necessary to resolve this issue.

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