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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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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.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz/public-consultation**

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 at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

Below is a list of recent items out for consultation. You can get copies from **www.ird.govt.nz/public-consultation/** or by emailing **public.consultation@ird.govt.nz**

Ref	Draft type	Title	Comment deadline
ED0194	General determination	Depreciation rate for rapid DC car charging stations	10 June 2017
PUB00268	Question we've been asked	Resident and Non-resident Withholding Taxes: non-cash dividends	23 May 2017
PUB00249	Interpretation statement	Fringe benefit tax - motor vehicles	19 May 2017
ED0191	General determination	Depreciation rate for campervans and motorhomes	19 May 2017

IN SUMMARY

IN SUMMARY

Questions we've been asked (continued)

This Question We've Been Asked is about when land is acquired under s CB 15B. Generally this will be when the first interest in the land (ie, the particular estate) arises. In a typical land purchase this will be when a binding contract to purchase the land is formed.

The QWBA also sets out when the 2-year period starts for the bright-line test. This is generally not the same as the date of acquisition of the land for other tax purposes.

The QWBA updates the Commissioner's previously published views on the tax implications of nominations.

Legislation and determinations

Any investment by a New Zealand resident investor in NZDH-A-DURH shares of Russell Investment Company plc that provide holders with an interest in the pool of investments held by Russell Global Bond Fund, is a type of attributing interest for which a person may not use the Fair Dividend Rate method to calculate Foreign Investment Fund income from the interest for the 2017 and subsequent income years.

This determination relates to a funding transaction involving the issue of Notes by the Bank to wholesale investors pursuant to a Deed Poll. The Notes will contain a conversion mechanism, whereby the Bank will immediately and irrevocably convert Notes into ordinary shares in Bank upon the occurrence of a Non-Viability Trigger Event, in order to allow them to be recognised as Tier 2 capital for the purposes of the Reserve Bank of New Zealand framework relating to the capital adequacy of banks.

This determination relates to an arrangement involving the finance, design, construction and on-going provision of operational services in respect of the Facilities by a limited partnership under a public-private partnership agreement with the Crown.

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company and foreign investment fund rules for the 12 months ending 31 March 2017.

Legal decisions - case notes

Due to updated Civil Aviation Rules, Queenstown Airport Corporation Limited ("QA") was required to provide a minimum 90-metre Runway End Safety Area ("RESA") at each end of its runway. Due to the steep drop-off into the Shotover River on the east end of the runway, QA constructed a 45-metre high embankment upon which to place the RESA and sought to deduct the construction costs on the basis the RESA was a depreciable land improvement.

The High Court rejected this argument and QA appealed. The Court of Appeal agreed with the High Court, and found that the allowed depreciable land improvements contained within Schedule 13 was an exhaustive list. There was no indication that a generous interpretation could be taken to allow items such as RESAs to be included. The Court also agreed that the RESA was not the same as an airport runway, was not an improvement to a runway, and was not hardstanding so could not fall within those categories of depreciable land improvement. Nor was the RESA expected to decline in value. For these reasons the Court dismissed the appeal.

IN SUMMARY

Legal decisions - case notes (continued)

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**

Disposition of real property for inadequate consideration – BR Pub 05/02 to 05/10 – notice of withdrawal

This is a notice of withdrawal of public rulings made under s 91DE of the Tax Administration Act 1994.

On 8 June 2005, the Commissioner issued the following binding public rulings (the Rulings), with application from 1 April 2005 for an indefinite period:

- BR Pub 05/02 "Disposition of real property for inadequate consideration where following a grant of a life estate, the balance is transferred to another person – Gift duty and income tax implications"
- BR Pub 05/03 "Disposition of real property for inadequate consideration where following a grant of a lease, the balance is transferred to another person – Gift duty and income tax implications"
- BR Pub 05/04 "Disposition of real property for inadequate consideration where following the transfer to another person, a life estate is granted back – Gift duty and income tax implications"
- BR Pub 05/05 "Disposition of real property for inadequate consideration where following the transfer to another person, a lease is granted back – Gift duty and income tax implications"
- BR Pub 05/06 "Disposition of real property for inadequate consideration where following the transfer to another person, a licence is granted back – Gift duty and income tax implications"
- BR Pub 05/07 "Disposition of real property for inadequate consideration where the transferor purports to grant him or herself a licence to occupy and transfer the balance – Gift duty and income tax implications"
- BR Pub 05/08 "Disposition of real property for inadequate consideration where there is a "simultaneous" grant of a life estate and transfer of the balance to another person – Gift duty and income tax implications"
- BR Pub 05/09 "Disposition of real property for inadequate consideration where there is a "simultaneous" grant of a lease and transfer of the balance to another person – Gift duty and income tax implications"
- BR Pub 05/10 "Disposition of real property for inadequate consideration where the transferor purports to "simultaneously" grant a licence and transfer the balance to another person – Gift duty and income tax implications"

These Rulings consider the gift duty and income tax implications of dispositions of real property for inadequate consideration where part of the estate was either retained by, or returned to, the vendor by way of a grant of a life estate, lease, or licence.

Gift duty was repealed with effect from 1 October 2011. Therefore, the Rulings are now largely historical. In addition, the Court of Appeal's recent decision in *CIR v Vector Limited* (2016) 27 NZTC 22-065 has rejected the Commissioner's earlier interpretation of the term "other revenues" in s CC 1 of the Income Tax Act 2004, which is discussed in the commentary to the Rulings.

Therefore, the Commissioner is withdrawing the Rulings with effect from 10 May 2017.

Product ruling BR Prd 17/02

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 Logbook Me Pty Ltd and Fleet NZ Ltd.

Taxation Laws

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

This Ruling applies in respect of:

- ss CX 6, CX 38, DE 7 and RD 29; and
- s 75(3BA) of the Goods and Services Tax Act 1985 (GSTA).

The Arrangement to which this Ruling applies

The Arrangement is the use of the LogbookMe product (LogbookMe) by taxpayers to record details of their vehicular trips. LogbookMe is a cloud-based online platform which uses an on-board electronic recording device to log data about a vehicles' trip. Logbook Me Pty Ltd (LMP) an Australian registered and resident company owns and maintains the LogbookMe product, which is licensed on a wholesale basis to Fleet NZ Ltd (FleetPartners). Hardware and sim card connectivity is supplied by LMP to FleetPartners for sale directly to customers in New Zealand. LMP provides provisioning support and manages the service. FleetPartners is the exclusive distributor of LogbookMe in New Zealand.

LogbookMe can be used by New Zealand individuals and businesses to record all vehicle journeys. It allows the driver to classify and generate reports on the business use of the vehicle. This subsequently enables the calculation of a business use percentage.

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

LogbookMe components

1. LogbookMe consists of the components set out in the following paragraphs.
2. An in-car device (Device) that is installed in the car to capture journey information. The Device:
    - contains an accurate GPS module, movement sensors, solid state memory, mobile communication modules, sim card, battery and power socket;
    - monitors car usage, including the position of the vehicle, start and end locations of journeys, start and stop times, start and stop date and total distance travelled;
    - is powered by connecting directly to the car's On Board Diagnostics (OBD) port;
    - commences recording the following data when it senses movement and/or ignition in the car:
        - car registration;
        - a record of all trips made by the relevant car;
        - date of trip;
        - start time of each trip;
        - end time of each trip;
        - start odometer;
        - end odometer;
        - total kilometres travelled during the trip; and
        - trip details (including start and end address);
    - records that data onto the Device memory with identifiers, including the time and date of each capture; and
    - automatically and continuously transmits the recorded data to the data management platform using a wireless mobile connection (should coverage on the mobile network not be available, it will automatically store the recorded data (up to approximately 30,000 trips) and periodically resend it until successful).
3. Car and employee registration with secure login and password features (SSL encrypted using a case sensitive password). This registration occurs at the time when the Device is ordered and the account is set up by the LogbookMe support team.

4. A cloud-based online remote data management platform (Platform) which is hosted in Australia. The Platform that securely receives, processes, reports and stores the journey information. In particular, it:
   - receives all transmissions continuously whilst the Device is operating and verifies data integrity upon receipt. The Platform then processes the transmissions and generates a log for the specific Device that represents an individual driver. Part of the processing includes collation of various transmissions to create individual trips (Trip Log).
   - collates Trip Logs that then appear in the smartphone application and web browser dashboard for the driver to classify each trip.
5. A smartphone based mobile application (App) and the web browser-based secure dashboard portal (Portal), both of which allow the driver to easily classify journey information and record the purpose or purposes of each journey as follows:
   - After the creation of each Trip Log, the driver will receive an in-device notification (if using the App) prompting for journey classification and to record the purpose, or purposes, of the journey. Alternatively, the driver may also use the Portal, which is enabled with the same functionality to classify the journey and record the purpose, or purposes, of the journey.
   - The driver will need to confirm and classify each trip as follows:
     - the date and time when each journey began and ended;
     - the respective odometer readings at beginning and end of each journey;
     - the number of kilometres travelled by the car in the course of the journey;
     - the purpose of the trip; and
     - whether the trip was business or personal.
   - To assist the driver, the App and Portal can be set to automatically overlay the driver's calendar entries and auto-fill the field for recording the purpose, or purposes, of the journey. Where this function is utilised, the driver is required to review and validate the auto-fill calendar information and may also make necessary edits. The purpose, or purposes, of the journey is not recorded until the user has validated and saved the record by press of a button. Prior to this step, the record will remain unclassified.
   - Where the driver has not classified a trip within 48 hours (or timeframe as agreed by the employer or individual), the driver will receive an email notification requesting that they log in to the App or Portal to classify any outstanding Trip Logs.
   - Data entered on a smartphone application or web interface will transmit to the server immediately once saved by the user. The user then receives feedback on the success of the transmission. If the transmission is not successful, the user is advised to resubmit.
   - A timestamp is recorded to the database when a trip is classified by a certain user, whether performed on a smartphone application or web interface.
   - At any given time, the driver will be able to view all unclassified trips on the App and Portal. The driver is then able to classify each trip individually and record the purpose, or purposes, of the journey.
6. The Portal allows the employer and driver to:
   - view, review and generate reports on all data (including device, driver, car details) that are exportable in English to a variety of file formats (including .xls, .csv and .pdf);
   - obtain the business use percentage, which has been determined by the business distance travelled divided by total distance travelled (which includes both personal and business distance travelled);
   - obtain information on all relevant items and recorded fields, which include:
     - car registration;
     - start date of logbook period, including opening kilometres;
     - end date of logbook period, including ending kilometres;
     - a record of all trips made by the relevant car;
     - date of trip;
     - start time of each trip;
     - end time of each trip;

  - start odometer;
  - end odometer;
  - total kilometres travelled during the trip;
  - trip details (including start and end address);
  - classification of trip (business or personal);
  - detail of the purpose, or purposes, of the journey;
  - any unclassified trips; and
  - any days remaining in the logbook term;
- capture data for different periods of time, including the 'test period' (a period of 12 weeks), the full duration the car was held or any other period of time that the user wishes to determine a log for.

7. The employer also has a summary of all drivers, including:
   - user attributes (including name and car registration details);
   - start odometer reading;
   - end odometer reading;
   - business usage percentage;
   - number of unclassified trips;
   - last trip;
   - start date of logbook;
   - end date of logbook; and
   - days remaining in logbook period.

Set-up

8. At the time the Device is ordered, either the employer or the individual provides set-up information that is input upon set-up of the user account. This information includes the following:
   - name of driver;
   - car registration;
   - car make and model;
   - engine size;
   - carrying capacity;
   - email address for user notifications and App configuration;
   - login and password details; and
   - the name of the employer.
9. This set-up process allows the user to utilise the Device and the Platform. The above information can be reviewed and revised by the car driver at any time through the Portal. This information can also be reviewed by the employer. If any anomalies are identified by the employer, the employer can communicate these anomalies to the employee so that appropriate changes can be made.
10. The Platform is activated for use when the Device is dispatched to the user and, from that point, is available to receive journey information at any time while the Device is operating. Upon receipt of the Device and it being placed in the relevant car, the user will be prompted to enter the below information prior to commencing their first trip:
    - login and password details;
    - opening odometer reading from the vehicle's built-in odometer; and
    - time zone.
11. LogbookMe's optional recording periods are currently either a 12-week period or a 52-week period. Users may easily extend the usage period beyond the set periods and, if so, the Trip Log will continue to be populated by data received on the Platform.

12. LogbookMe can also allow multiple drivers to classify trips using a Shared Car Module in the LogbookMe Platform. Similar to the process described above, this would allow for multiple drivers to login to cars that they have used and classify the relevant trips.

Security

13. LogbookMe's In-Car Logbook Solution data is securely stored on the Platform and is:
    - automatically backed up on a daily basis at 4pm, and retains 7-day running snapshots, as well as weekly and monthly snapshots, to protect the integrity of information;
    - IP locked for database and remote access and staff are provided limited access on an as needed timed basis locked to a static IP address at a specific location;
    - very transparent and has a full audit trail capturing the metadata in the event any trip information or account information is changed.
14. LMP regularly updates its data management platform for the latest security patches and IP locked firewalls are in place for database and remote access. All staff and contractors are instructed to safeguard sensitive records and are provided limited access on an as needed timed basis locked to a static IP address at a specific location. This ensures that the risk of unauthorised alteration, addition or deletion is minimised as much as possible.
15. In addition, LMP's data storage provider, Amazon Web Services Asia Pacific (AWS), stores LogbookMe's objects on multiple devices across multiple facilities across Australia and regularly verifies the integrity of LogbookMe's data using checksums. This is designed to sustain concurrent device failures by quickly detecting and repairing any lost data.
16. Further, a versioning backup system (databases exist in several versions at the same time) allows LMP to preserve, retrieve and restore every version of every object stored in AWS. This provides LMP with an additional level of protection by providing a means of recovery if objects are inadvertently overridden or deleted.
17. As a final step to ensuring the integrity of data, LMP permits only its technical director to have permanent access to its data management platform. All other LogbookMe user accounts are protected by a SSL (Secure Sockets Layer) encryption using a case sensitive password. This ensures that only authorised personnel have access to electronic records.
18. FleetPartners has a direct feed which provides a live carbon copy of all client data from LMP via an Application Program Interface (API) that is provided in real time by LMP. This data is stored in New Zealand by FleetPartners for fleet management and reporting. This is hosted on a local server located at the FleetPartners office in Mount Wellington, Auckland.
19. LMP's data retention policy for current, future and former clients is to maintain records indefinitely.

Data integrity checks

20. Upon completion of the logbook, the driver will be prompted to enter the odometer reading as displayed on the car odometer at the end of the logbook period. The Portal will then determine whether there is any variance between the closing odometer reading determined by the GPS compared to the car odometer reading.
21. If the variance between the total distance measured by the GPS compared to the car odometer reading is greater than an acceptable variance (as pre-determined by the employer and the driver), the employer and driver will be notified.
22. Where it is deemed that the variance is not acceptable, the driver will have the option to continue the logbook period or to restart the logbook period. This prevents the driver from overstating business kilometres travelled by having a referenced GPS calculation, and ensures accuracy and integrity of the calculation.

Customer Agreement

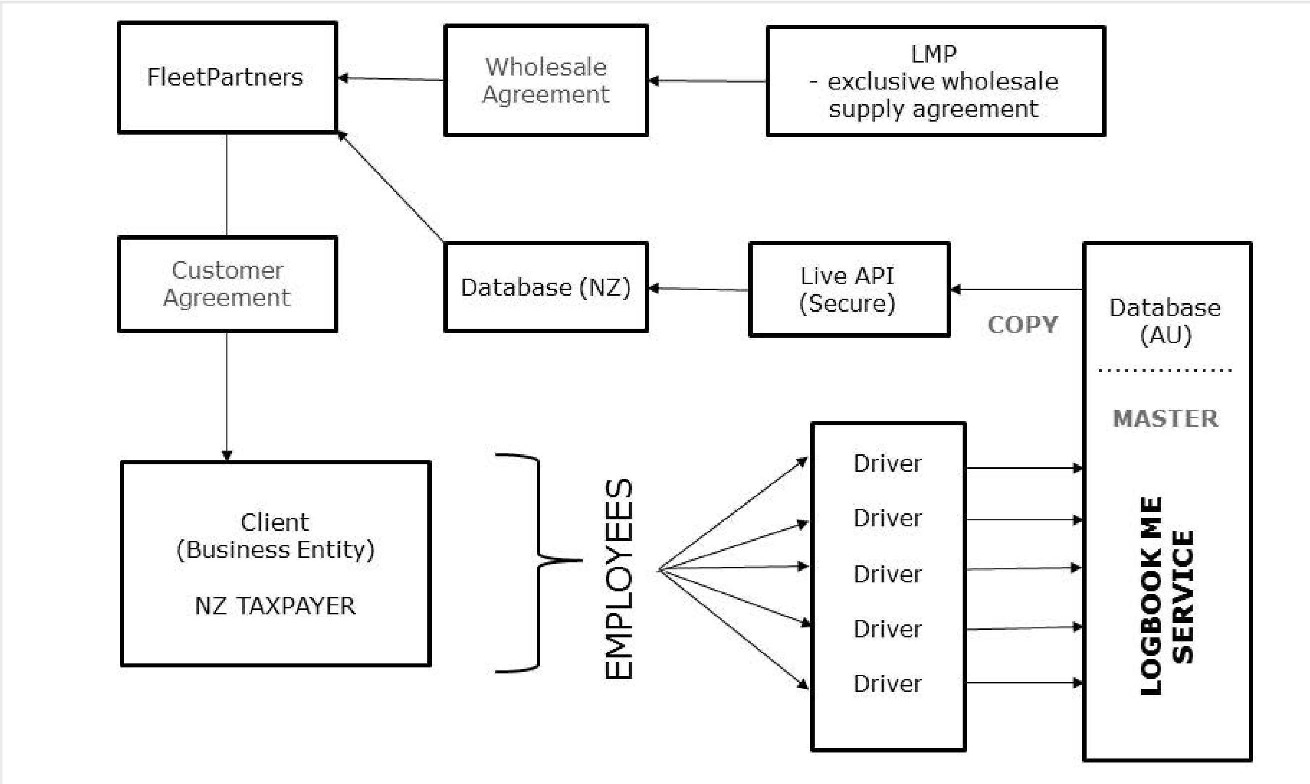
23. The Customer Agreement: Online Telematics Service (Customer Agreement) a copy of which was provided to Inland Revenue on 9 March 2017, sets out the terms and conditions under which FleetPartners supplies LogbookMe to its customers.
24. Clause 20 of the Customer Agreement sets out the record keeping obligations of FleetPartners as follows:

    20 Record Keeping

    FleetPartners must maintain, for a period of 7 years after the end of the income year or taxable period to which they relate, separate and accurate records of all Customer Data related to this agreement. These records will remain readily accessible to the Customer and the End User for the 7 years after the end of the income year or taxable period to which they relate.

25. Clause 19.5 of the Customer Agreement provides that cl 20 of the Customer Agreement will survive termination of the Customer Agreement.

26. The following diagram summarises how the Arrangement operates:



Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The taxpayer accurately fills out the required fields in LogbookMe.

b) The taxpayer does not remove the Device from the vehicle during the log book period.

c) LogbookMe operates appropriately and accurately to record all relevant vehicle trip data.

d) LogbookMe satisfies the requirements of s 26 of the Electronic Transactions Act 2002.

How the Taxation Laws apply to the Arrangement

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

a) Taxpayers who use LogbookMe will satisfy the record-keeping requirements of s 75(3BA) of the GSTA for those records that are generated by LogbookMe.

b) A taxpayer's use of LogbookMe will satisfy the logbook record keeping requirements set out within s DE 7 provided:

- the logbook is kept for a minimum of 90 consecutive days;
- the logbook is kept at a time that represents, or is likely to represent, the average proportion of travel by the vehicle for business purposes during the "logbook term" (as defined in s DE 8); and
- the Commissioner has not required the taxpayer to record additional information in its logbook under s DE 7(2)(f).

c) A taxpayer who uses LogbookMe will meet the requirements for recording the trip-related data (but not the non-trip-related data) for a "test period" under s RD 29(6) to establish the taxable value of the fringe benefit arising from making a vehicle available to an employee. This is provided that:

- LogbookMe is set to record the trip details during the test period for three consecutive months of an income year (where the taxpayer pays fringe benefit tax (FBT) on an income year basis) or a quarter (where FBT is paid quarterly or annually);
- the taxpayer chooses a test period that shows, or is likely to show, a pattern of use of the motor vehicle by the employee that fairly represents the use of the vehicle by the employee over the whole of the applicable "term" (as determined pursuant to s RD 31(6)–(8)); and

- the taxpayer independently records the number of days a motor vehicle was available, but not actually used, for private use over the period referred to above. However, if the vehicle is a work-related vehicle (as defined in s CX 38(1) and (2)), then the taxpayer does not need to record any days on which the vehicle was available for the following private use:
  - travel to and from their home that is necessary in, and a condition of, their employment; or
  - other travel in the course of their employment during which the travel arises incidentally to the business use.

d) A taxpayer who uses LogbookMe will record the trip-related data (but not the non-trip-related data) required to satisfy the work-related vehicle exclusion for FBT purposes under s CX 6(2) and to ascertain any private use days that may arise under s CX 38(3). This is provided that:

- the taxpayer independently records the number of days a motor vehicle was available, but not actually used, for private use over the period referred to above, other than private use that is:
  - travel to and from their home that is necessary in, and a condition of, their employment; or
  - other travel in the course of their employment during which the travel arises incidentally to the business use.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2017 and ending on 1 April 2020.

This Ruling is signed by me on the 3rd day of April 2017.

Howard Davis
Director (Taxpayer Rulings)

NEW LEGISLATION

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

Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill was introduced on 8 August 2016.

The three main policy proposals in the Bill were: changes to make the taxation of business tax simpler, including new provisional tax rules, implementing the G20/OECD standard for Automatic Exchange of Information in financial accounts, and changes to tighten New Zealand's disclosure requirements for foreign trusts, as recommended by the Government's inquiry into foreign trust disclosure rules.

The Bill received its first reading in Parliament on 11 August 2016, its second reading on 7 February 2017 and its third reading on 14 February 2017. The new Act received Royal assent on 21 February 2017.

It amends the Income Tax Act 2007, the Tax Administration Act 1994 and the Student Loan Scheme Act 2011.

AUTOMATIC EXCHANGE OF INFORMATION

Sections BH 1, YA 1, of the Income Tax Act 2007; sections 3, 22, 89C, 89P, 91AAU, 91AAV, 91AAW, 94A, 94C, 142H, 142I, 143, 143A, 185E to 185J, 185L, 185N to 185R, 226D, 226E, Schedule 2 of the Tax Administration Act 1994

Changes have been made to the Income Tax Act 2007 and the Tax Administration Act 1994, to incorporate the G20/OECD standard for Automatic Exchange of Financial Account Information in Tax Matters into New Zealand domestic law.[1]

The standard is usually referred to as "Automatic Exchange of Information", "AEOI", or the "AEOI standard".

AEOI is a global initiative, led by the G20 and OECD, to address the international problem of "offshore tax evasion" (that is, evading tax by hiding wealth in offshore accounts).

Broadly, a jurisdiction implements the AEOI standard by enacting legislation that requires financial institutions to:

- conduct **due diligence** on their financial accounts to identify those held or (in certain circumstances)[2] controlled by non-residents; and
- **report** specified identity information (including tax residence) and financial information (such as account balances and interest earned) in respect of those accounts to their local tax administration.

Implementing jurisdictions must also have an appropriate network of tax treaties in place to exchange the reported information with applicable participating jurisdictions.

Although different types of tax treaty can be used for this purpose, AEOI exchanges will predominantly be made under the joint OECD/Council of Europe *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*.[3]

The exchanged information will be used by tax administrations to verify compliance with tax obligations.

This *Tax Information Bulletin* item outlines and explains the legislative changes at a relatively high level. Inland Revenue is supplementing this information with comprehensive guidance that will deal with the application of the AEOI standard and this implementation legislation at a detailed technical level. (The guidance was issued in draft form in December 2016, and submissions were called for by 28 February 2017. After the submissions are reviewed the guidance will be finalised and published on Inland Revenue's website.)

[1] For information on the standard see **http://www.oecd.org/tax/automatic-exchange/**.

[2] Certain entity account holders must be "looked through" to identify the ultimate natural persons who have effective control or deemed control of the financial account.

[3] For information on the Convention see **http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/**.

Key features

The AEOI implementation legislation focuses on imposing the necessary due diligence and reporting obligations on financial institutions. (Exchanging the reported information is primarily a tax treaty matter and generally does not require implementation legislation.)

The due diligence and reporting obligations to be imposed are set out in an element of the AEOI standard known as the *Common Standard On Reporting And Due Diligence For Financial Account Information* (in short, the "Common Reporting Standard" or "CRS").[4]

The CRS is also supplemented by a comprehensive official OECD Commentary (referred to throughout this *Tax Information Bulletin* item as the "OECD Commentary").

The approach adopted in the legislation is essentially to incorporate the CRS directly into New Zealand law by reference, and to require the application of the CRS to be consistent with the OECD Commentary.

Because of similarities between the CRS and the related United States Foreign Account Tax Compliance Account (FATCA) initiative, the CRS implementation legislation has primarily been located (and merged) with the FATCA framework legislation in Part 11B of the Tax Administration Act 1994.

The general scheme of Part 11B has been retained. Section 185E, which sets out the purpose of Part 11B, has been updated to include references to the CRS and to outline the new structure. Some provisions in Part 11B (namely sections 185F to 185M) apply solely to FATCA, some (sections 185N and 185O) apply solely for CRS purposes and some (sections 185P to 185R) apply for both FATCA and CRS purposes.

A number of other amendments have been made to the Income Tax Act 2007 and the Tax Administration Act 1994, to support the operation of Part 11B. These include:

- new definitions (in both Acts);
- new record-keeping provisions (in subsection 22(2) of the Tax Administration Act);
- new penalty provisions (in sections 89C, 142H and 142I of the Tax Administration Act);
- new determination and Order in Council-making powers (in new sections 91AAU, 91AAV, 91AAW, 226D and 226E of the Tax Administration Act); and
- a new Schedule 2 to the Tax Administration Act (modifying the application of the CRS to New Zealand).

All of these amendments are detailed and explained in this *Tax Information Bulletin* item.

Terminology

Given that the focus of the legislation is on incorporating CRS obligations into New Zealand law, the information here will primarily refer to the CRS rather than AEOI or the AEOI Standard.

The CRS contains numerous definitions that are potentially confusing. Examples include:

- The term "entity" includes legal arrangements such as trusts, which would not normally be the case under New Zealand law.
- The terms "financial institution" and "financial account" have wider application than might normally be expected. For instance, a professionally managed investment trust that meets specified criteria will be a financial institution for CRS purposes. Moreover, a settlor or beneficiary of such a trust will be deemed to hold a financial account with the trust.

New Zealand start date

The start date to which the New Zealand Government has committed internationally, and from which the legislation provides that CRS obligations are to apply in New Zealand, is 1 July 2017.

Due diligence

The legislation specifies due diligence procedures that financial institutions must undertake in order to determine if any of their accounts are held or (if "look-through" rules apply) controlled by non-residents.

- From 1 July 2017, the due diligence procedures must be conducted in respect of all **new accounts**.[5]
  - Due diligence for new accounts will generally involve obtaining, on account opening, **self-certifications** that contain the required identity and tax residence information.

[4] For information on the CRS see **http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/**.

[5] A new account will generally be one opened on or after 1 July 2017.

- From 1 July 2017, financial institutions must also begin due diligence reviews in respect of all **pre-existing accounts**.[6]
  - Different due diligence procedures are specified for different types of pre-existing accounts. In general, however, financial institutions will often be able to rely on documentation and/or information that they have already obtained for other regulatory or customer relationship purposes.[7]
  - The due diligence for pre-existing **high value[8] individual** accounts must be completed by 30 June 2018.
- The due diligence for **all other** pre-existing accounts (that is pre-existing lower value individual accounts[9] and all pre-existing entity accounts) must be completed by 30 June 2019.

Reporting

The legislation also imposes an annual reporting requirement on a financial institution that determines, pursuant to the above due diligence procedures, that it has one or more "reportable accounts". (That is, an account that is held or (if the "look-through" rules apply) controlled by non-residents.)

The New Zealand **reporting period** for CRS purposes will align with the New Zealand tax year (that is, the 12-month period ending 31 March).[10]

The annual **reporting deadline** for financial institutions for each reporting period will be 30 June following the end of the reporting period. The information that must be reported for each reportable account for each reporting period is:

- **identity information** (including the tax residence) for each non-resident account holder and (if applicable) controlling person; and
- **financial information**, including the account balance or value as at the end of the reporting period, and specified income earned (such as interest) and distributions made during the reporting period.

If a financial institution is unable to determine the status of a pre-existing account, in specified circumstances it will be required to report the account as an "**undocumented account**".

Grace periods for due diligence

Each annual CRS reporting period ends on 31 March. Accounts identified as reportable during a reporting period are to be reporting on to Inland Revenue by the following 30 June.

However, to provide financial institutions with as much time as possible for conducting due diligence of pre-existing accounts, a grace period of three months applies beyond the 31 March reporting period end date for the first two years of CRS reporting.

- The deadline for completing due diligence of pre-existing high value individual accounts is 30 June 2018 (rather than 31 March 2018).
- Similarly, the deadline for completing due diligence of all other pre-existing accounts (that is, lower value individual accounts and all entity accounts) has been set at 30 June 2019 (rather than 31 March 2019).

Crucially, however:

- the 30 June reporting deadline still applies, meaning that due diligence and reporting to Inland Revenue must **both** be completed by 30 June; and
- accounts identified as reportable during each grace period must be included in the reporting period to which the grace period relates (this is referred to as a "**carry-back rule**").

Thus, due diligence reviews of pre-existing high value individual accounts and all reporting for these accounts must be completed by 30 June 2018. The carry-back rule means that the account balance or value to be reported will be as at 31 March 2018, and income to be reported will be income earned in the period ending 31 March 2018.

Similarly, due diligence reviews of all other pre-existing accounts (lower value individual accounts and all entity accounts) and reporting for these accounts must be completed by 30 June 2019. The carry-back rule means that the account balance or value to be reported will be as at 31 March 2019, and income to be reported will be income earned in the period ending 31 March 2019.

[6] A pre-existing account will generally be one already open at 30 June 2017.

[7] In particular, this includes information obtained from compliance with anti-money laundering/countering the financing of terrorism "know-your-customer" laws.

[8] Generally, high value accounts are those with an account balance exceeding US$1 million.

[9] Generally, lower value accounts are those with an account balance that does not exceed US$1 million.

[10] However, by virtue of the 1 July 2017 start date, the duration of the first period (from 1 July 2017 to 31 March 2018) will be nine rather than 12 months.

An exception to the carry-back rule applies if the account would not have been reportable before 31 March. This could happen, for example, if the account holder's status changed from non-reportable (for example, New Zealand-resident) to reportable (for example, non-resident) after 31 March. In such a case, if the account was identified as reportable in the period from 1 April to 30 June, it would not need to be reported until the following 31 March (rather than the previous 31 March).

CRS optionality

Some optionality is contemplated under the CRS and OECD Commentary. For example, the CRS provides that pre-existing entity accounts should not be reviewed unless the account balance or value exceeds US$250,000. However, the OECD Commentary provides implementing jurisdictions the option of ignoring this de minimis threshold.

The implementation legislation generally allows financial institutions the discretion to adopt the option that best suits their circumstances.

However, the legislation withholds some options for New Zealand. These are the two key "**excluded choices**":

- The reporting period to be used by all New Zealand financial institutions is the year ending 31 March.
- The CRS "wider approach" to due diligence will be mandatory for all New Zealand financial institutions.

These excluded choices are explained further below.

Compliance framework

The CRS requires implementing jurisdictions to introduce rules for ensuring compliance. These include anti-avoidance rules and effective sanctions for addressing non-compliance. To meet this requirement, the implementation legislation includes a compliance framework with an anti-avoidance rule and certain penalties.

The compliance framework applies to financial institutions and also extends to other persons and entities that hold or control accounts with such institutions, or that otherwise act as intermediaries in relation to accounts.

This reflects the fact that effective implementation of the CRS requires a chain of information effectively flowing from account holders, controlling persons and intermediaries, to financial institutions and then to Inland Revenue (for international exchange).

Background

International context and New Zealand's commitment to implement AEOI

To date, 101 jurisdictions have committed to implement AEOI with a view to completing first exchanges by 30 September 2018 at the latest. This includes:

- all G20 and OECD member countries; and
- all other jurisdictions identified by the G20 or OECD as having or operating as an international finance centre.

Jurisdictions other than those identified above can also implement the AEOI standard, but will not be subject to implementation deadlines (unless they are subsequently identified by the G20 or OECD as an emerging tax risk).

As an OECD member, New Zealand has made an international commitment to implement AEOI and to complete its first international information exchanges by the 30 September 2018 deadline.

Of the 101 committed jurisdictions, 55 have committed to complete their first exchanges by 30 September 2017. These are generally referred to as early adopters. The other 46 jurisdictions (which includes New Zealand and Australia) are working towards the 30 September 2018 deadline.

The success of the global AEOI initiative depends on jurisdictions implementing consistent rules, to a similar implementation timeline. Otherwise there is a high risk of the offshore tax evasion problem merely relocating to jurisdictions that lag behind or implement to a lesser standard.

To ensure consistency and timeliness, the OECD's global tax body, the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum"), will lead peer reviews and other forms of monitoring to ensure that jurisdictions correctly implement the AEOI standard in a timely manner. The Global Forum will report the outcome of its reviews to the G20, which is positioned to apply possible sanctions against non-complying jurisdictions, if necessary.

Relation to other international initiatives

AEOI is a stand-alone initiative, but is related to other international developments aimed at improving transparency frameworks and tax compliance. In particular, the CRS reflects (and is largely based on) the US FATCA initiative, which New Zealand implemented in 2014.

The CRS builds off the FATCA initiative in a number of ways. For example, both regimes have broadly similar types of entities, financial institutions, financial accounts, due diligence procedures (including sometimes allowing financial institutions to rely on anti-money laundering/countering the financing of terrorism "know your customer" ("AML") procedures and other account information that they already hold), and reporting requirements.

However, there are some differences between the regimes. Below are some key examples.

- FATCA due diligence is focused on identifying "US persons" (which includes US citizens as well as residents). CRS due diligence applies only to **non-residents** and not **foreign citizens**.[11]
- FATCA contains a number of de minimis exclusions from due diligence and reporting. The CRS generally does not have such exclusions. The one exception to this is for pre-existing entity accounts, where the threshold exemption is US$250,000, unless the financial institution chooses to opt out of the threshold.
- FATCA compliance is buttressed by a 30% withholding tax to apply to US-sourced income for non-compliance. This does not apply to the CRS. The CRS therefore requires implementing jurisdictions to have a legal and operational compliance framework in place to verify compliance, penalise non-compliance and counter potential CRS avoidance arrangements.

In addition, FATCA implementation involved the incorporation of the necessary due diligence and reporting rules (which are set out in a treaty-level instrument)[12] into New Zealand law by regulations.[13] The CRS is not a treaty-level instrument, and incorporation into New Zealand law therefore requires specific legislation.

Other elements of the AEOI standard

As noted, the CRS is the element of the overall AEOI standard that sets out the due diligence and reporting obligations for financial institutions of participating jurisdictions.

The other elements of the AEOI standard generally relate to the exchange of AEOI information between jurisdictions. This includes model competent authority agreements and the data schema to be used for exchanges.

A common IT solution for encrypting and transmitting data between jurisdictions, referred to as the Common Transmission Standard, is also being developed by the OECD.

All exchanges of information with other jurisdictions will be made under New Zealand's tax treaties.

The legal instruments for exchange

Any form of tax treaty can potentially be used to make AEOI exchanges. However, the G20 and OECD have promoted the joint *OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters* ("Multilateral Convention") as the principal treaty to be used for this purpose.

New Zealand signed the Multilateral Convention in 2012. It was given legal effect in New Zealand on 21 October 2013 by an Order in Council made under section BH 1 of the Income Tax Act 2007.[14]

Section BH 1 authorises the making of an Order in Council to give legal effect to a "double tax agreement". As that term is defined, and under statutory legal principles, the reference to "double tax agreement" in section BH 1 can apply to a wide range of tax treaty types, including multilateral treaties. However, this was not immediately obvious from the wording. This has led to some claims that the Multilateral Convention was not correctly given legal effect in New Zealand.

Although a legal challenge to the validity of the Order in Council giving effect to the Multilateral Convention is unlikely to be successful, any uncertainty is undesirable. Moreover, additional multilateral treaties may need to be given effect under section BH 1 in the future.

[11] As explained in the detailed analysis section, the legislation makes the CRS option of the "wider approach" to due diligence mandatory for all New Zealand financial institutions. This means CRS due diligence in New Zealand will focus on identifying all foreign tax residents, rather than only the residents of implementing jurisdictions.

[12] An Intergovernmental Agreement between New Zealand and the US. The agreement is available on Inland Revenue's tax policy website at **http://taxpolicy.ird.govt.nz/tax-treaties/united-states-america#iga**.

[13] The Double Tax Agreements (United States of America-FATCA) Order 2014.

[14] Details about the Multilateral Convention are available on Inland Revenue's tax policy website at **http://taxpolicy.ird.govt.nz/tax-treaties/convention-mutual-administrative-assistance-tax-matters**.

Accordingly, the legislation includes a retrospective amendment to section BH 1 to put the matter beyond doubt, by clarifying that it also applies to multilateral treaties.

The definition of "foreign account information-sharing agreement", in section YA 1 of the Income Tax Act 2007, has also been amended to specifically include the Multilateral Convention. This supports the change made to section BH 1 with a reference to the Multilateral Convention being brought into force by an Order in Council made under section BH 1. It also clearly links the Multilateral Convention (and other applicable tax treaties) to the agreements to which Part 11B of the Tax Administration Act 1994 applies.

Article 6 of the Multilateral Convention authorises automatic exchanges of information (as opposed to other forms of exchange, such as on request). It provides that automatic exchanges must be subject to detailed terms as agreed between "competent authorities".

To give effect to the Article 6 requirement for competent authorities to agree the detailed terms of automatic exchanges for AEOI, the OECD developed an administrative instrument referred to as the *Multilateral Competent Authority Agreement* (MCAA). New Zealand signed the MCAA in 2015.[15]

Competent authorities are generally specific persons or authorities nominated by each treaty partner to administer the treaty. The competent authority under New Zealand's tax treaties is the Commissioner of Inland Revenue.[16]

In addition to other important details, such as the manner of exchanges and rules, and procedures around maintaining confidentiality of exchanged data, the MCAA specifies the actual information to be exchanged between the parties.

The MCAA also has a notification mechanism, which enables each party to confirm the actual jurisdictions that it will exchange with (see the explanation of "reportable jurisdictions" below), and the timing of exchanges with each of those jurisdictions. This notification mechanism is administered by the OECD, and will be publicised online on the OECD's AEOI portal.[17]

New Zealand will provide notifications on reportable jurisdictions when its list of reportable jurisdictions is finalised.[18]

Application dates

The legislative amendment to section BH 1, clarifying that the section applies in the case of multilateral treaties, has retrospective application from 21 October 2013. As noted above, this is to put beyond doubt that section BH 1 applies to the Multilateral Convention (which has had legal effect in New Zealand since 21 October 2013).

Otherwise, the legislative amendments came into force on the date of Royal assent, being 21 February 2017.

Detailed analysis

This *Tax Information Bulletin* item outlines and explains the legislative changes at a relatively high level. Inland Revenue is supplementing this report with comprehensive guidance that will deal with the application of the AEOI standard and this implementation legislation at a detailed technical level.

Incorporating the CRS and OECD Commentary into New Zealand law

The due diligence procedures and reporting requirements set out in the CRS are supplemented by a comprehensive OECD Commentary.

Rewriting the CRS's rules into domestic law in a way that ensures consistency with the OECD Commentary could risk inadvertent differences and gaps between the CRS/OECD Commentary and the domestic implementation legislation. Moreover, the CRS and OECD Commentary will almost certainly be subject to future change, as deficiencies and improvements are identified, and in response to possible changes in future taxpayer behaviour.

To ensure that the CRS is correctly incorporated into New Zealand law, and reduce the risk of deficiencies being identified during international peer review, the AEOI standard has been incorporated into domestic law by direct reference to the CRS and the OECD Commentary, as published.

[15] For information about the MCAA see http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/.

[16] The Commissioner may delegate competent authority status.

[17] See http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/.

[18] The mechanism for confirming New Zealand's reportable jurisdictions is covered further below.

To facilitate the incorporation of the CRS by reference, three key definitions have been inserted into section 3(1) of the Tax Administration Act 1994:

- "**CRS publication**", which refers to the official OECD publication that includes the full AEOI standard (the Standard for Automatic Exchange of Financial Account Information in Tax Matters);[19]
- "**CRS standard**", referring to Part IIB of the CRS publication, which is where the CRS is located; and
- "**CRS applied standard**", meaning the CRS standard as modified by section 185O and Schedule 2 of the Tax Administration Act 1994.[20]

As noted, the CRS must be interpreted and applied consistently with the official OECD Commentary, which is in Part IIIB of the CRS publication. New section 185O(3) of the Tax Administration Act 1994 incorporates that requirement into New Zealand law.

Importantly, the definition of "CRS standard" includes the words "as amended from time to time". This means that future changes to the CRS will generally flow through into New Zealand legislation automatically.

The CRS is an international standard, and New Zealand's compliance with it will be peer reviewed by the OECD's Global Forum. The G20 has stated its intention to apply sanctions, when appropriate, in response to identified non-compliance. This applies equally to any future changes to the CRS. Therefore, the automatic flow-through of future changes into New Zealand law is considered to be appropriate.

As a safeguard, however, new section 226E allows Orders in Council to be made, if necessary, to facilitate, block or defer particular CRS changes.

Note that section 185O(3)(b) also states "as amended at the time", thereby ensuring that future changes to the OECD Commentary also automatically apply.

Other definitions

The approach of incorporating the AEOI implementation legislation into existing Part 11B of the Tax Administration Act 1994 involves merging the AEOI rules into the concept of a **foreign account information-sharing agreement**, on which Part 11B is based. To achieve this, the definition of "foreign account information-sharing agreement" (in section YA 1 of the Income Tax Act 2007) has been amended to include the Multilateral Convention (which, as noted above, will be the tax treaty predominantly used for AEOI exchanges).

The CRS itself contains a large number of specific definitions. Generally, the approach of incorporating the CRS into New Zealand law by reference will ensure that these definitions will automatically apply in the application of the CRS in New Zealand.

However, in the event of a conflict between a CRS definition and a defined term in the Inland Revenue Acts, a rule has been inserted in new section 185O(4) of the Tax Administration Act 1994 to ensure that when applying the CRS standard, the CRS definition will generally take precedence.

The OECD Commentary specifies that two terms ("**passive income**" and "**maintain**") are to take their domestic law meaning, but they must also include certain things. To ensure that the full meaning set out in the OECD Commentary will apply in New Zealand, specific definitions of these terms have been included in section 3(1) of the Tax Administration Act 1994.

Other amendments in section 3(1) to ensure the legislation works correctly include new definitions of "information" (to clarify that it includes a self-certification) and "taxpayer identification number" (to clarify the application to a functional equivalent number in a foreign jurisdiction).

A new term "**FATCA agreement**" has also been introduced in section 3, as a means of differentiating between FATCA and AEOI in Part 11B.

Framework for CRS obligations

Because the CRS due diligence and reporting obligations are incorporated into New Zealand law by reference, the legislation generally does not need to detail specific obligations. Rather, the AEOI implementation legislation is primarily concerned with establishing the framework under which the CRS obligations will apply in New Zealand.

[19] This publication is available on the OECD website at **http://www.oecd.org/ctp/exchange-of-tax-information/ standard-for-automatic -exchange-of-financial-account-information-for-tax-matters-9789264216525-en.htm**. Inland Revenue will issue a New Zealand version of the CRS on its website, with all domestic law modifications (such as key dates and the wider approach to due diligence) included.

[20] The legislation modifies the CRS to clarify the application of options, dates (such as the dates that are to apply for due diligence and reporting purposes) and other items as necessary.

Section 185O sets out the specific modifications to be made to the CRS standard for application in New Zealand (as the CRS applied standard).

Section 185N of the Tax Administration Act 1994 applies the obligations to financial institutions.

Section 185P of the Tax Administration Act 1994 applies the obligations to persons or entities other than financial institutions (such as account holders, controlling persons or intermediaries).

Some complexity arises from the fact that the CRS treats certain legal arrangements (particularly trusts and partnerships) as entities. As this does not match New Zealand law, section 185Q provides that any obligations in the CRS that apply to an entity are to apply to the relevant natural person in the New Zealand context. (For example, for trusts, the obligations will apply to the trustees, and for partnerships, each partner.)

The framework is supplemented by amendments to section 22 of the Tax Administration Act 1994 that insert specific record-keeping requirements in relation to compliance with Part 11B of the Act.

This includes a specific requirement for financial institutions that are subject to Part 11B to:

- keep a record of any failure to obtain a self-certification; and
- keep a record of the steps taken and evidence relied upon in meeting obligations under Part 11B relating to the CRS applied standard.[21]

Modifications to the CRS

Section 185O(2) of the Tax Administration Act 1994 provides that a number of specific modifications are set out in new Schedule 2 to the Tax Administration Act 1994. (These are detailed further below.)

Section 185O(3) of the Tax Administration Act 1994 provides that the CRS is to be applied consistently with the OECD Commentary, as amended at the time.

Section 185O(4) of the Tax Administration Act 1994 effectively provides that a CRS definition will prevail in any conflict with a domestic law definition.

Section 185O(5) of the Tax Administration Act 1994 generally permits financial institutions to make elections contemplated in and consistent with the CRS and OECD Commentary. Section 185O(6) provides that after making an election, the person or entity must meet the requirements of the CRS applied standard consistently with that election.

Schedule 2 of the Tax Administration Act 1994

New Schedule 2 makes the following specific modifications to the CRS:

- Item 1 clarifies that references in the CRS to reporting period and calendar year should generally mean a 12-month reporting period ending 31 March.
- Items 2 and 3 mandate the use of the wider approach for due diligence. This is an important compliance minimisation option offered to implementing jurisdictions in the CRS. It is explained below, in the section "The wider approach".
- Item 4 withdraws a choice available in the CRS to allow a transitional period for the introduction of a requirement to report gross proceeds from the sale or redemption of financial assets. The reasons for this are explained below under "Excluded choices".
- Items 5 to 10 set out various due diligence timeframes that apply for the different types of pre-existing accounts.
- Item 11 provides an option relating to certain employer-sponsored group insurance contracts or annuity contracts.
- Item 12 provides that dollar amounts referred to in the CRS (which are in US currency), can be treated as being in New Zealand dollars.
- Items 13 and 22 to 24 all link to the lists of New Zealand's participating jurisdictions, reportable jurisdictions, non-reporting financial institutions and excluded accounts, which will need to be published. This is explained below.
- Item 14 sets out the date at which a credit card issuer is required to implement various defined policies and procedures in order to be a "qualified credit card issuer" as defined in the CRS.
- Items 15 and 16 set out various dates from which collective investment vehicles must no longer issue physical shares in bearer form and by which they must have policies in place to ensure that such shares are redeemed or immobilised in order to be an "exempt collective investment vehicle" as defined in the CRS.

[21] This is required each CRS reporting period irrespective of whether or not the financial institution has any CRS information that is required to be reported to Inland Revenue.

- Items 17 and 18 define "pre-existing account" and "new account". The definition of "pre-existing account" incorporates the option in the CRS to apply the due diligence procedures for pre-existing accounts to new accounts opened by pre-existing customers in circumstances permitted in the CRS.
- Items 19 and 20 set out dates that apply for determining whether a pre-existing individual account is a "lower value account" or a "high value account".
- Item 21 sets out a deadline date by which a financial institution is required to implement defined policies and procedures in order for a type of overpaid depository account to be an "excluded account".
- Item 25 replaces the definition of the term "related entity" in the CRS with the optional definition (in paragraph 82 of Section VIII) in the OECD Commentary. The replacement definition of "related entity" generally refers to whether an entity is controlled by another entity or whether two entities are under common control, or whether two managed investment entities are under common management.

Much of new Schedule 2 is concerned with inserting the key CRS implementation dates and timeframes that are to apply in New Zealand. These include the date on which CRS obligations begin, dates for determining whether a financial account is a new account or a pre-existing account, and the deadlines for financial institutions to complete due diligence and reporting.

In the CRS and OECD Commentary, these dates have generally been left open for each implementing jurisdiction to insert via domestic implementing law (subject to meeting international expectations).

In addition, because New Zealand's reporting period is different from the default calendar year reporting period in the CRS, a rule is included to ensure that all references to reporting period and calendar year are to be read in the context of the New Zealand tax year (unless the context requires otherwise).

Obligations of financial institutions

The CRS provides that a financial institution that is resident (as that concept applies for CRS purposes) in a jurisdiction will be subject to CRS obligations in that jurisdiction.

However, a branch of a New Zealand-resident financial institution located outside of New Zealand is excluded from the rules. Conversely, a branch of a non-resident financial institution located in New Zealand is subject to the New Zealand rules.

These fundamental rules are repeated in section 185N(1) and (2).

The CRS also includes a complex series of definitions that set out the actual criteria for identifying financial institutions.

For CRS purposes, the term "**financial institution**" is broadly defined. It extends beyond traditional financial institutions (such as banks) to a wide range of entities that would not normally be considered to be financial institutions in New Zealand (for example, it will include some professionally managed trusts).

However, the CRS also specifies a number of categories of financial institution that pose a low risk of being used to facilitate offshore tax evasion, and which therefore are excluded from the due diligence and reporting obligations. These are defined as "**non-reporting financial institutions**".

Section 185N(3) provides that a financial institution must comply with the due diligence and reporting obligations set out in the CRS applied standard.

Section 185N(4) imposes an annual reporting deadline for financial institutions of 30 June following the 31 March reporting period end date.

Consistent with the timeframes in the CRS and OECD Commentary for completing due diligence of pre-existing accounts, section 185N(5) sets a deadline of 30 June 2018 for due diligence and reporting on pre-existing high value individual accounts, and 30 June 2019 for due diligence and reporting for all other pre-existing accounts. Otherwise, section 185N(5) includes a general rule for the timing of reports in respect of an account identified as reportable during a particular reporting period.

Section 185N also includes other supplementary rules that clarify the application of certain options in the CRS.

Obligations of persons other than financial institutions

Section 185P extends CRS obligations to persons other than financial institutions.

This reflects the fact that financial institutions will often be required to collect documentation and information directly or indirectly from account holders (and sometimes the controlling persons of the account) in order to comply with their CRS obligations. This includes circumstances when the institution has a customer relationship with an intermediary that holds an account for the benefit of an account holder and, potentially, other controlling persons.

This requires an efficient transfer of information from those account holders and other persons directly or indirectly to the financial institution.

Financial institutions are required to obtain documentation and information from customers on account opening.[22] However, they may face challenges in obtaining necessary documentation and information from customers in other circumstances. For example, a pre-existing customer may not respond to a written request for information. There may also be difficulties obtaining documentation and information from persons connected with particular types of accounts, such as trust accounts.

To assist compliance, section 185P imposes an obligation on such customers and other persons or entities, to obtain and provide any information that the financial institution requests from them, directly or indirectly, that is needed to satisfy the institution's CRS due diligence obligations.

Section 185P also requires customers and other relevant persons or entities to provide updates on any material change in circumstances that they are aware of that may affect their status as a reportable person. For example, if a customer has provided a self-certification to a financial institution that they are a New Zealand resident, and they subsequently become non-resident, that change of residence status should be notified to the financial institution.

Record-keeping obligations

The CRS specifically requires implementing jurisdictions to have rules in place that require financial institutions to keep records of the steps undertaken, and any evidence relied upon, in meeting their CRS obligations.

This requirement is covered by the introduction of specific rules in section 22 of the Tax Administration Act 1994. These include a requirement for a financial institution to keep a record if they cannot obtain a required self-certification. The new record-keeping requirements will assist Inland Revenue in verifying compliance with the CRS and addressing any non-compliance (including considering penalties).

Optionality

Although the success of the AEOI global initiative depends on jurisdictions implementing similar rules, the CRS provides implementing jurisdictions with a number of options. These options have been developed with a view to minimising compliance costs for financial institutions in areas that are not considered likely to compromise the effectiveness of the CRS.

The circumstances of each financial institution can differ markedly, meaning that financial institutions may have different preferences as to whether these options should be adopted. Accordingly, the implementation legislation generally allows each financial institution to decide whether to adopt any particular option offered in the CRS.

Some of the specific choices available to financial institutions are set out in section 185N. Otherwise, subsections 185O(5) and 185O(6) generally provide that a financial institution may make an election that is expressed as being available to them (under the CRS and the Inland Revenue Acts).

Excluded choices

Section 185N(11) provides that the optionality in the CRS for alternative reporting periods, and in the OECD Commentary for the use of average balances rather than period-end balances, will not be available to financial institutions. In these two cases, a particular choice will be mandated for all financial institutions:

- **CRS reporting period** – the reporting period to be used in New Zealand will be the 12-month period ending 31 March.[23] This is consistent with the New Zealand tax year and the reporting period adopted by New Zealand for FATCA purposes. The period ending 31 March must be adopted by all financial institutions.
- **Average balances** – the OECD Commentary provides that jurisdictions that already require financial institutions to report average account balances can permit their financial institutions to maintain this approach for CRS, rather than reporting period-end balances. This does not apply in New Zealand. However, for clarity, the implementation legislation expressly provides that this option is not available to New Zealand financial institutions.

An additional excluded choice is set out at item 4 of Schedule 2. This relates to an option available in the CRS to allow a transitional period for the introduction of a requirement to report gross proceeds from the sale or redemption of financial assets in relation to a custodial account. On this point there is a mismatch between the CRS and the exchange commitments set out in the MCAA, where this is not allowed as an option. Therefore this has been specifically set out as an excluded choice.

[22] Inland Revenue's technical guidance will contain specific guidance on this point.

[23] Given New Zealand's 1 July 2017 start date, the first CRS reporting period will be a nine-month transitional period from 1 July 2017 to 31 March 2018.

The wider approach

The wider approach to CRS due diligence

An important option offered in the CRS is use of the wider approach to CRS due diligence. This option addresses the practical issue that the CRS prima facie requires financial institutions to only identify persons that are tax-resident in reportable jurisdictions (that is, jurisdictions that New Zealand has a commitment to provide CRS information to). Over time, additional jurisdictions will join the initiative and become reportable jurisdictions. Without specific rules, each new jurisdiction joining could trigger a new round of due diligence reviews of accounts by financial institutions.

To avoid this problem, and to minimise compliance costs, the CRS includes an option for implementing jurisdictions to adopt a wider approach to due diligence. Under this approach, a jurisdiction's financial institutions would collect and retain CRS information for all non-residents identified, rather than just for residents of reportable jurisdictions.

The CRS implementation legislation adopts the wider approach to due diligence. To ensure consistency, and to prevent a competitive disadvantage for any financial institution, this approach will be mandatory for all financial institutions.

This modification to the CRS standard is made at item 2 of the new Schedule 2.

The wider approach to CRS reporting

The wider approach to due diligence means that financial institutions will prima facie need to sort the collected data to determine which non-resident accounts need to be reported to Inland Revenue.

However, for CRS reporting, the implementation legislation allows a wider approach option for financial institutions to report *all* of the information to Inland Revenue. That is, financial institutions may choose to report information for all financial accounts held or controlled by a non-resident, not just those that are residents of reportable jurisdictions.

Financial institutions that adopt the wider approach reporting option will effectively pass the responsibility for sorting their non-resident data on to Inland Revenue, potentially saving compliance costs. Inland Revenue will be responsible for determining the information to be exchanged with reportable jurisdictions.

The wider approach to reporting option is set out in section 185N(7).

Section 185N(8) effectively provides that, once a financial institution elects to adopt the wider approach for a reporting period, it must report on that basis for that period. This "permitted choice" rule is consistent with the approach adopted for FATCA.

Determinations and regulatory powers

The terms "participating jurisdiction" and "reportable jurisdiction" are key concepts in the application of the CRS. The CRS requires New Zealand to publish lists of its participating jurisdictions and reportable jurisdictions.

The CRS also provides carve-outs from due diligence and reporting obligations for "non-reporting financial institutions" and "excluded accounts" that pose a low risk of being used for tax evasion purposes. Some generic categories of these are set out in the CRS. However, the CRS also provides that certain other financial institutions and accounts can be subject to the carve-outs, provided they are approved by Inland Revenue as meeting specified criteria.

New Zealand's lists of participating jurisdictions, reportable jurisdictions, approved non-reporting financial institutions and excluded accounts will be published by a mix of Commissioner's determinations and regulations.

Participating jurisdictions

A participating jurisdiction is generally one that has implemented AEOI and that will provide CRS information to other jurisdictions. More specifically, New Zealand's participating jurisdictions will be those with which an exchange agreement is in place for that jurisdiction to provide CRS information to New Zealand.

The CRS contains rules that require a financial institution to look through prescribed entities (referred to in the CRS as "passive NFEs") to determine the natural persons that are its ultimate controlling persons. This look-through rule extends to certain investment entities that are not from participating jurisdictions.

This means that New Zealand's list of participating jurisdictions will impact on the entity account holders that New Zealand financial institutions will need to look through to identify any ultimate controlling persons.

New section 91AAU of the Tax Administration Act 1994 provides that the Commissioner of Inland Revenue may make a determination about whether a particular jurisdiction is a participating jurisdiction. The provision authorises the Commissioner to limit, amend, suspend or withdraw a determination.

It will take time to confirm whether all jurisdictions that have committed to implementing AEOI have correctly carried through with their commitments. As a transitional measure, the OECD has permitted jurisdictions to tentatively treat all jurisdictions that have made international commitments to implement AEOI/CRS as participating jurisdictions. New Zealand will adopt this approach.

However, the transitional measure is only to apply for a limited time, and jurisdictions are required to publish final lists by 30 June 2017. Given that New Zealand's start date is 1 July 2017, the intended approach is to publish a transitional list that will apply for the first reporting period (1 July 2017 to 31 March 2018) and then a final list by 30 June 2017 that will apply from the beginning of the second reporting period (that is, from 1 April 2018).

Reportable jurisdictions

A participating jurisdiction is one that provides CRS information. A reportable jurisdiction is one that also wants to receive CRS information. Not all participating jurisdictions will be reportable jurisdictions. For example, some participating jurisdictions may not have a tax system[24] and therefore have no need to receive information.

In general, international expectations are that AEOI/CRS information will be provided to all jurisdictions that have signed the MCAA on the basis that they wish to receive such information. However, the OECD acknowledges that this raises potential concerns about confidentiality and data security.

AEOI/CRS exchanges will comprise sensitive personal and financial information. The terms of the legal instruments under which the information will be exchanged require this information to be used only for specified (tax) purposes and disclosed only to specified persons for such purposes.

Many jurisdictions have been exchanging such sensitive information for many years, have robust laws, processes and systems in place for ensuring exchanged data is kept secure and is only used for legitimate purposes, and have a track record of maintaining confidentiality in respect of exchanged information. However, some jurisdictions that are implementing the AEOI standard have had little, or no, prior experience in exchange of information for tax purposes.

Implementing jurisdictions may decide not to provide information to a particular jurisdiction if they have genuine concerns about confidentiality and/or data security. However, such decisions cannot be used to frustrate the purposes of the CRS.

This is a difficult balancing act. To assist, the Global Forum is conducting specific reviews of jurisdictions' confidentiality and data safeguards, and is making its conclusions available to jurisdictions implementing the AEOI standard.

New section 226D in the Tax Administration Act 1994 provides a regulation-making power for determining New Zealand's reportable jurisdictions. This will ensure that the New Zealand Government retains oversight and control over adding or removing jurisdictions from New Zealand's reportable jurisdictions list.

To ensure that, in the case of any serious breach, exchange of information with a particular jurisdiction can be swiftly suspended, the Commissioner of Inland Revenue will be authorised to make a determination to temporarily suspend that jurisdiction as a reportable jurisdiction. This determination-making power is contained in new section 91AAV (and its effect on the regulation, in section 226D(5)).

The section 91AAV determination power will only exist as a contingency to ensure that the time taken to make an Order in Council to suspend a jurisdiction does not result in a legal obligation to provide information despite a serious breach of confidentiality. Any determination made under section 91AAV will need to be subsequently confirmed by Order in Council or it will lapse.

Non-reporting financial institutions

As noted above, non-reporting financial institutions are not subject to CRS due diligence or reporting. The CRS provides for some generic categories of financial institution that will be non-reporting financial institutions. However, there is also a category of low risk financial institutions that an implementing jurisdiction can itself determine. These must meet certain specified criteria in the CRS, must be confirmed by the implementing jurisdiction in a published list, and must meet a final test of not frustrating the purposes of the CRS.

New section 91AAW of the Tax Administration Act 1994 provides for the Commissioner of Inland Revenue to make a determination as to whether a particular financial institution, or type of financial institution, is a non-reporting financial institution. The provision allows the Commissioner to limit, amend, suspend or withdraw a determination. All determinations made under this provision must be published.

[24] For example, some smaller economies that are international finance centres.

Certain low risk excluded accounts

Similarly, excluded accounts are not subject to CRS due diligence or reporting. A number of generic categories of excluded account are set out in the CRS. There is also an additional category of low risk accounts that an implementing jurisdiction can determine. However, these must also meet specified criteria in the CRS, must be confirmed by the implementing jurisdiction in a published list, and must meet a final test of not frustrating the purposes of the CRS.

Section 91AAW of the Tax Administration Act 1994 also provides for the Commissioner of Inland Revenue to make a determination as to whether a particular financial account, or type of financial account, is an excluded account. The provision allows the Commissioner to limit, amend, suspend or withdraw a determination. All determinations made under this provision must be published.

Enforcement

The CRS requires implementing jurisdictions to have rules and procedures in place to ensure compliance and address non-compliance. This includes having appropriate anti-avoidance rules, record-keeping requirements, compliance programmes and effective sanctions to address identified non-compliance (including countering avoidance arrangements).

Accordingly, the legislation includes a comprehensive suite of enforcement rules and penalties.

The penalties that can be imposed on financial institutions for not complying with CRS obligations are as follows.

"Absolute liability" penalties

Under subsection 142H(1) of the Tax Administration Act 1994, a civil penalty of $300 applies if a financial institution does not comply with any CRS due diligence or reporting requirement. However, subsection 142H(2) provides that this penalty will not be imposed if the failure was due to circumstances beyond a financial institution's control.

Under subsection 142H(3) of the Tax Administration Act 1994, a civil penalty of $300 applies if a financial institution does not obtain a self-certification on opening of a new account, when this is required by the CRS.

Under subsections 142H(2) and (4) of the Tax Administration Act 1994, a transitional period (until 30 June 2019) will apply during which penalties under subsections 142H(1) and (3) will not be imposed if the financial institution is able to demonstrate that it:

- made reasonable efforts to comply with its CRS due diligence and reporting obligations; and
- corrected the failure within a reasonable period of time after becoming aware of it.

Under subsection 142H(6) of the Tax Administration Act 1994, the penalties that may be imposed under sections 142H(1) and (3) must not exceed $10,000 per reporting period.

"Negligence" penalties

Under subsection 142H(5) of the Tax Administration Act 1994, a civil penalty of $20,000 for a first offence and $40,000 for any subsequent offence, may be imposed when a financial institution fails to take reasonable care in complying with its CRS due diligence and reporting requirements.

Under subsection 142H(6) of the Tax Administration Act 1994, the penalties that may be imposed under section 142H(5) must not exceed $100,000 per reporting period.

Intentional non-compliance

"Knowledge offences" by financial institutions will be subject to existing criminal penalties under section 143A of the Tax Administration Act 1994.

Under section 142H, civil absolute liability penalties and negligence penalties may not be imposed for the same offence.

Information providers

The penalties for financial institutions are also backed with specific obligations and penalties that apply to "information providers" who are account holders, controlling persons, or persons that otherwise hold accounts for the benefit of others (including trusts and intermediaries).

Under section 142I(2)(a)–(h) of the Tax Administration Act 1994, a civil penalty of $1,000 can be imposed on an information provider for each offence relating to a request for information (such as providing a false self-certification or not providing a self-certification within a reasonable period of time).

Under section 142I(2)(i) of the Tax Administration Act 1994, a civil penalty of $1,000 can also be imposed on an information provider for not providing notification[25] of a material change in circumstances within a reasonable time.

However, under subsections 142I(3) and (4) of the Tax Administration Act 1994, imposition of these penalties is subject to a "no fault" defence (for a failure to provide information or a self-certification within the control of the information provider) and a "reasonable efforts" defence (for a failure to provide information or a self-certification relating to another person or entity and not within the control of the information provider).

Other enforcement amendments

Section 89C of the Tax Administration Act 1994 has been amended to enable Inland Revenue to impose any of the civil penalties under sections 142H and 142I by issuing a notice of assessment (that is, without first having to issue a notice of proposed adjustment).

Section 143 of the Tax Administration Act 1994 has been amended to ensure that criminal "absolute liability" penalties cannot be imposed under that section for non-compliance with Part 11B of the Act. (This is because sections 142H and 142I of the Act provide for absolute liability penalties.)

In addition, section 143A of the Tax Administration Act 1994 has been amended to enable criminal "knowledge" penalties to be imposed for knowingly failing to provide information or a self-certification.

As advised, specific record-keeping obligations relating to compliance with Part 11B of the Tax Administration Act 1994 have been inserted into section 22(2) of the Act.

An anti-avoidance provision that will apply to CRS arrangements and practices entered into or by financial institutions, persons or intermediaries with "a main purpose" of avoiding an obligation under Part 11B of the Tax Administration Act 1994, has been inserted into the Act as new section 185R.

"Reasonable efforts" to comply

The mix of transitional measures and available defences included in the above rules reflects the fact that the rules are complex, that financial institutions face short implementation timelines, and that there is therefore a risk of inadvertent error by financial institutions and information providers.

The intended approach is that for the first two years, reasonable efforts by financial institutions to comply will be recognised. For that time, sanctions will generally only be imposed in cases of intentional non-compliance or lack of reasonable care.

FATCA-related amendments

For consistency, the legislation also extends certain CRS obligations to FATCA. These include:

- aligning the FATCA anti-avoidance rule with the AEOI/CRS anti-avoidance rule (with application to any person with an obligation under Part 11B of the Tax Administration Act 1994);
- extending the record-keeping obligations in respect of Part 11B to FATCA as well as AEOI/CRS; and
- providing for the imposition of the same obligations and penalties on persons other than financial institutions (information providers) under FATCA as for AEOI/CRS.

FOREIGN TRUST DISCLOSURE RULES

Sections 3(1), 22 (2), 22(7), 59B-59E, 81(4) of the Tax Administration Act 1994; sections HC 11 and HC 26 of the Income Tax Act 2007

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced increased disclosure requirements for foreign trusts with New Zealand-resident trustees. These include requirements for the trust to register with Inland Revenue, file annual disclosure returns, and pay registration and filing fees. In addition, the register of foreign trusts would be shared with certain New Zealand government agencies.

The resident trustee of the foreign trust would need to comply with the registration and filing obligations in order to qualify for the exemption from tax on foreign-sourced income.

The amendments contained in the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act require existing trusts to apply for registration by 30 June 2017. Foreign trusts that are formed after the enactment of these amendments (21 February 2017) have 30 days to apply for registration.

[25] The Special Report on AEOI published on Inland Revenue's tax policy website on 28 February 2017 (see **http://taxpolicy.ird.govt.nz/news/2017-02-28-special-reports-new-legislation**) incorrectly states that Inland Revenue must be informed. However, the obligation to inform is to the person or entity that made the request.

Background

New Zealand taxes trusts on the basis of the tax residence of the settlor. Accordingly there is an exemption in section CW 54 of the Income Tax Act 2007 for foreign-sourced amounts derived by resident trustees. The eligibility for the exemption is set out in section HC 26.

The changes follow the Government's April 2016 Inquiry into Foreign Trust Disclosure Rules. The Inquiry was set up to examine and make recommendations regarding disclosure rules and other related matters to ensure that New Zealand's reputation is maintained. The Inquiry recommended a formal registration process for foreign trusts and increased disclosures of information. The Inquiry also considered that the Department of Internal Affairs and New Zealand Police should be able to access the information.

These changes are important to protect New Zealand's reputation as having best practice in contributing to global exchange of information.

These disclosure requirements are imposed on a New Zealand resident trustee of the foreign trust.

Key features

Registration of a foreign trust

Resident foreign trustees will be required to register foreign trusts with Inland Revenue under new section 59B(2). A contact trustee is responsible for the communication with the Commissioner of Inland Revenue and must provide the required information about the foreign trust. In many cases, it is likely that there will only be one resident foreign trustee, who will therefore also be the contact trustee. If a foreign trust has more than one resident foreign trustee, each of them is responsible for the performance of the trustee obligations, but they will need to decide who will be the contact trustee and will communicate the information to Inland Revenue. These include registering the trust, disclosing information required as part of registration, filing annual disclosure returns and paying fees.

If the contact trustee expects to stop being a resident foreign trustee of a trust, for example if they will no longer be a New Zealand resident, they must inform the Commissioner of the date they expect this to happen and the details of any replacement contact trustee.

An amendment is also made to the definition of a foreign trust in section HC 11 to ensure a foreign trust is defined at a point in time rather than when a distribution is made. This ensures that all foreign trusts with a New Zealand-resident trustee must comply with the disclosure rules, regardless of whether a distribution has been made.

Registration for existing foreign trusts

New section 59B replaces the previous section 59B which covered the disclosure of information for foreign trusts. The previous section 59B included requirements to disclose certain information as part of an initial disclosure to Inland Revenue and subsequently to provide any changes to these details within 30 days.

The previous foreign trust disclosure process is being replaced by a more extensive disclosure regime with a formalised registration process. Following enactment (21 February 2017), the previous disclosure rules no longer apply.

Resident foreign trustees of existing foreign trusts will have until 30 June 2017 to apply for registration of the foreign trust and provide the relevant information. This registration will include providing some information that was already included as part of the trust's initial disclosure, alongside the more extensive requirements which have been introduced.

Registration details

Replacement section 59B stipulates what information must be provided with the application to register the trust with Inland Revenue. If the contact trustee does not provide any of the information this may affect the eligibility for the exemption on tax for foreign-sourced income derived by resident trustees.

Annual disclosure returns

Resident trustees of a foreign trust will be required to file annual returns, including the trust's financial statements, and details of settlements and distributions made over the year. The due date for filing the return is six months after the foreign trust's balance date, or 30 September if the trust does not have a balance date (being six months after the end of New Zealand's tax year).

The contact trustee must also provide any updates to the information provided at registration within 30 days after becoming aware of the alteration.

Registration and annual filing fee

New section 59E prescribes a registration fee of $270 and an annual filing fee of $50. This section also includes a regulation-making power which will allow these fees to be amended by Order in Council. This section also allows natural persons who are not in the business of providing trustee services to be exempt from the fees.

Concessions for natural persons not in the business of providing trustee services

The previous disclosure requirements introduced in 2006 included a grace period of two years for new migrants who are not in the business of providing trustee services. In recognition of the increased disclosure obligations on resident foreign trustees, this grace period has been extended to four years. The eligibility for the grace period has also been extended more generally to situations where all trustees are natural persons not in the business of providing trustee services. This gives the resident foreign trustee more time to understand their obligations and comply with the disclosure rules.

This change, along with several other concessions, has been introduced to reduce compliance costs for foreign trusts when all trustees of the foreign trust are natural persons not in the business of providing trustee services. These concessions recognise that not all foreign trusts are intended to be established as such and some people may become resident foreign trustees of foreign trusts due to changes in circumstances (for example, such as a trustee migrating to New Zealand or acting as an executor of a trust).

For consistency, these concessions should all apply in the same circumstances across the board, so that non-professional trustees can readily ascertain what concessions are available to them.

These concessions include increased time to comply with registration requirements, limited information required about settlements, and a waiver of registration and annual return fees. The concessions available to non-professional trustees are discussed in further detail in later sections of this *Tax Information Bulletin* item.

Summary of registration requirements and concessions

	At least one trustee is not a natural person or is in the business of providing trustee services	All trustees are natural persons not in the business of providing trustee services
Time limits for application for registration	If the foreign trust exists on the date of Royal assent (and the resident foreign trustee is already appointed as a trustee), the resident foreign trustee must apply to register the trust by 30 June 2017. If the foreign trust is established after the date of Royal assent or a resident foreign trustee is appointed after the enactment of the legislation, the resident foreign trustee must apply to register the trust within 30 days of becoming the resident foreign trustee.	The trustee must apply to register the trust within four years and 30 days from the date that the trustee became a resident foreign trustee (that is, when the trustee was appointed or became a New Zealand resident). If the resident foreign trustee has held that role for more than four years and 30 days before enactment of the legislation, the deadline is 30 June 2017. If there are multiple resident foreign trustees, the grace period begins on the earliest date that any of the trustees became a resident foreign trustee.
Information required on application for registration	Copy of the trust deed.	Copy of the trust deed.
	Identifying particulars and contact details for settlors, trustees and beneficiaries.	Identifying particulars and contact details for settlors, trustees and beneficiaries.
	Signed declaration that relevant persons are aware of their legal obligations to provide information and will do so.	Signed declaration that relevant persons are aware of their legal obligations to provide information and will do so.

	Information about settlements made from date of formation until the date of application.	For trusts first required to register on date of Royal assent, information about settlements dating back to 30 June 2013 (or formation, if later). For trusts first required to register after date of Royal assent, information about settlements dating back four years (or formation, if later). See the section "Information required on registration" and the subsection "Historical settlements".
Registration application fee	$270 including GST.	**Exempt – see "Fees" section.**
Subsequent changes to information	Within 30 days.	Within 30 days.
Annual disclosure return	Within six months of balance date or end of the tax year with a copy of financial statements, and details about settlements and distributions made during the return year.	Within six months of balance date or end of tax year with a copy of the financial statements, and details about settlements and distributions made during the return year.
Annual return filing fee	$50 including GST per return year.	**Exempt – see "Fees" section.**

Eligibility for tax exemption

Foreign-sourced income derived by a New Zealand-resident trustee is exempt income under section CW 54 of the Income Tax Act 2007 if certain criteria are met. The criteria are set out in section HC 26. The amendments to section HC 26 ensure that the foreign trust must comply with the increased disclosure obligations in order to be eligible for this tax exemption.

Information sharing with other agencies

An exception to the secrecy provisions will allow the information contained in the foreign trust register to be shared with the Department of Internal Affairs and New Zealand Police.

The Finance and Expenditure Committee also recommended that Inland Revenue should be able to share information with the Overseas Investment Office. This will take the form of an Approved Information Sharing Agreement between Inland Revenue and the Overseas Investment Office.

Consequential amendments

Certain definitions and record-keeping requirements have been repealed due to the extended disclosure requirements.

Application dates

The amendments came into effect on the date of Royal assent, being 21 February 2017.

For foreign trusts in existence at the date of Royal assent, the resident foreign trustee must apply for registration of the trust by 30 June 2017.

Detailed analysis

Tax exemption for foreign-sourced amounts: resident trustees

New Zealand taxes trusts on a settlor basis. One result of this is an exemption for foreign-sourced amounts derived by trustees resident in New Zealand if the trust is classified as a foreign trust.

This tax exemption was available to all New Zealand-resident trustees before the enactment of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill. However, if the trustee was convicted of a knowledge offence and was not a qualifying resident foreign trustee, they did not qualify for the exemption.

The amendments to section HC 26 tighten the criteria for the tax exemption. These amendments require the resident foreign trustee to comply with the disclosure obligations for the income year in which the income is derived.

Trust deed required for exemption

The Commissioner may register a foreign trust regardless of whether it has a trust deed. However, the tax exemption on foreign-sourced amounts will only be available to resident foreign trustees if the trust has a trust deed, even if all other registration and ongoing requirements are met.

The rationale behind requiring a trust deed in order to qualify for the exemption is to counter possible circumvention of the disclosure obligations by using documentation other than a trust deed or verbal agreements to avoid disclosing information to Inland Revenue. The trust deed is a vital piece of information and it is important for it to be provided to Inland Revenue and other enforcement agencies.

Eligibility for exemption

The eligibility for an exemption on foreign-sourced income of the trust is assessed each year. A foreign trust that is not registered on time will lose its exemption for that year.

If the foreign trust is later registered, it will be able to get the exemption for the years for which it has met its disclosure obligations.

Generally, the trust must be registered at the time the income is derived to qualify for the tax exemption in section CW 54. In addition, subsections HC 26 1(c) and (d) provide rules around when the trust must be registered to qualify for the exemption.

Application made within time limits under section 59C

If a resident foreign trustee applies for registration within the time limit given by new section 59C (the "application period"), and registration is completed by the end of the income year after the application period (the "post-deadline year") then for any subsequent years they will qualify for the exemption as long as the trust remains registered and the trustee meets their obligations.

Resident foreign trustees must comply with all their obligations under sections 22, 59B, 59C and 59D of the Tax Administration Act 1994 for the income year in order for the trust to qualify for an exemption on foreign-sourced trustee income.

Example

XYZ Trust is formed on 1 November 2016, and Frank, a New Zealand resident, is appointed as a trustee. Frank has until 30 June 2017 to apply to the Commissioner for registration of XYZ (see the "Time limits for registration" section for more details).

Frank applies for registration within the time specified in section 59C, and the registration process for XYZ Trust is completed one month after the end of the application period. The trust is fully registered with Inland Revenue on 1 August 2017. Any foreign-sourced trustee income will be eligible for an exemption from New Zealand tax under section CW 54 if all the conditions specified in section HC 26(1)(c) are met.

For the XYZ Trust's foreign-sourced trustee income to qualify for the exemption, the following conditions must be met.

(a) XYZ Trust must have a trust deed.

(b) XYZ Trust is not deregistered before the foreign-sourced income is derived.

(c) The resident foreign trustee (Frank) must also comply with all the requirements under sections 22, 59B, 59C and 59D as they arise during the income year.

For example, if XYZ adds a beneficiary on 5 September 2017, Frank will need to provide Inland Revenue with the required information on the additional beneficiary within 30 days, under section 59C.

Application made outside time limits under section 59C

If the resident foreign trustee does not apply for registration within the application period, the trust can qualify for the tax exemption in future if it is registered from the beginning of the income year when the foreign-sourced income is derived and the trustee fulfils their obligations for that income year. As is the case for trusts who apply for registration within the timeframe given under section 59C, the trust must have a trust deed.

Example

Tiny Tunes Trust was formed on 1 May 2016, at which time they appointed a New Zealand-resident trustee, Jazz Ltd. Following Royal assent of the new legislation, Jazz Ltd has until 30 June 2017 to apply for registration of Tiny Tunes Trust.

However, Jazz Ltd applies for registration of Tiny Tunes Trust on 1 September 2017. For the income year beginning 1 April 2017, Tiny Tunes Trust will not be eligible under section HC 26 for the tax exemption on foreign-sourced trustee income.

If Jazz Ltd applies and completes the registration of Tiny Tunes Trust by 31 April 2018, they will be eligible for the income exemption on foreign-sourced trustee income if the conditions set in section HC 26(1)(d) are met.

Ongoing compliance with obligations

To qualify for the exemption the trust must meet the registration requirements. In addition to these, the resident foreign trustee must comply with the requirements under sections 22, 59B, 59C and 59D as they arise in the income year.

Section 22 contains record-keeping requirements. Section 59B sets out the obligations for registering a trust and what information must be provided. (See the section "Information required on registration" for more details.)

Section 59C specifies the timeframes for registering the trust and updating the details provided at registration.

Obligations in relation to annual returns are contained in section 59D. Annual return due dates are discussed in the section "Annual disclosure returns and financial statements".

Non-compliance when reasonable efforts made

Amended section HC 26 provides discretion for the Commissioner of Inland Revenue to allow the exemption to still apply if the trustee has made an error in registration requirements. This is provided for by new subsection (1B).

If a resident foreign trustee makes an error or does not comply with the requirements under sections 22, 59B, 59C or 59D, the exemption for foreign-sourced trustee income may still apply if the Commissioner is satisfied that the trustee made reasonable efforts to comply with the requirements and remedied the error within a reasonable timeframe.

Repeal of qualifying resident trustee

The previous tax exemption criteria in section HC 26 recognised "qualifying resident trustees" and provided that the exemption would still be available even if a knowledge offence were committed, as long as one or more resident foreign trustees were qualifying resident trustees. A "qualifying resident trustee" was defined as a member of an approved organisation, or for a trustee that is not a natural person, a director or person with significant influence over the entity would have to be a member of an approved organisation.

The concept of a qualifying resident trustee, and the lesser sanctions that applied in these cases have been repealed.

Requirement to register foreign trust

Amended section 59B(2) provides that resident foreign trustees of a foreign trust must apply to the Commissioner for registration of the foreign trust.

Section 59B(1) provides that the Commissioner may approve the application for registration of a foreign trust, if the foreign trust has a resident foreign trustee and the application fee has been paid. However, other registration requirements must also be met before approval. These are set out in sections 59B(3) and (4).

To be eligible for the foreign-sourced income exemption under section HC 26 of the Income Tax Act 2007, a foreign trust must be registered with the Commissioner of Inland Revenue. This is discussed in the section above "Tax exemption for foreign-soured amounts: resident trustees". "Time limits for registration" below provides further detail on the timeframes for registration.

Definition of a foreign trust

An amendment has been made to section HC 11 in the Income Tax Act which classifies when a trust is a foreign trust. This section has been amended to apply at a moment in time rather than in relation to a distribution. This ensures that it is not necessary for a foreign trust to have made a distribution before the disclosure obligations apply.

It is important to note that there are existing disclosure obligations regarding foreign trusts established in New Zealand. The previous definition of a foreign trust in relation to a distribution does not appear to have caused any significant uncertainty in practice. However, given the more extensive disclosure obligations, and higher compliance requirements for the tax exemption on foreign-sourced trustee income, the definition has been clarified to ensure there is no ambiguity.

Example

Henry is a New Zealand resident for tax purposes. He is appointed as a trustee of the newly formed MNO Trust, which has one settlor who is resident in the United Kingdom.

MNO Trust has not made any distributions to beneficiaries of the trust. On the date of his appointment as a trustee for MNO Trust, Henry will be required to register MNO Trust under section 59B(2) of the Tax Administration Act 1994.

Resident foreign trustees

A resident foreign trustee is defined in section 3(1) of the Tax Administration Act as a person who:

- acts as a trustee of a foreign trust that is not registered as a charitable entity under the Charities Act 2005; and
- is resident in New Zealand within the meaning of sections YD 1, YD 2 or YD 3 (excluding section YD 2(2)) of the Income Tax Act 2007.

This definition is unchanged from the previous disclosure requirements for foreign trusts. Amendments were made during the select committee stage of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill to ensure the use of the same term and provide consistency.

Contact trustee

It is possible that a foreign trust may have more than one resident foreign trustee. Section 59B(7) provides that if there is more than one resident foreign trustee each resident foreign trustee is responsible for meeting obligations relating to the foreign trust, including registration, disclosure of information, annual returns, financial statements and payment of fees.

However, the trustee who applies for registration of the foreign trust then becomes responsible for communicating with the Commissioner on matters relating to the trust and is known as the "contact trustee". The contact trustee is the only trustee that is required to communicate the required information to the Commissioner. This is provided for in section 59B(3). This provision allows the resident foreign trustees to choose the contact trustee and avoids duplication of effort and information.

If the contact trustee relinquishes that role (for example, if they are no longer a trustee or become non-resident), new subsection 59B(6) requires them to provide the name and contact details of the new contact trustee and the date on which this trustee will take over the duties of the contact trustee. The outgoing contact trustee must also confirm their own contact details or provide their updated contact details to the Commissioner.

Example

Jazz Ltd is a resident foreign trustee and currently the contact trustee for Tiny Tunes Trust. Jazz Ltd is being wound up and will no longer be a trustee. Tiny Tunes Trust has another New Zealand-resident trustee, Brass Ltd.

Jazz Ltd and Brass Ltd decide on the date that Brass Ltd will become the contact trustee for the trust. Jazz Ltd informs Inland Revenue that it will no longer be the contact trustee for Tiny Tunes Trust and that Brass Ltd will take over the role, and the date this will happen. Jazz Ltd also confirms its own current contact details and advises the email address and business address of Brass Ltd.

Time limits for registration

The criteria for eligibility for the tax exemption in amended section HC 26 of the Income Tax Act 2007 is connected to the time limits for registration set in section 59C of the Tax Administration Act 1994.

New section 59C sets out the time limits for applying to register the trust and the time limits for updating the information that must be disclosed. There are three different time limits, depending on the trust's category:

- trusts that become required to register **after** the date of enactment (new trusts);
- trusts that become required to register **on** the date of enactment (that is, existing foreign trusts with resident foreign trustees at time of enactment); and
- trusts where each trustee is a natural person not in the business of providing trustee services.

Foreign trusts will always be in one of the first two categories, but if they also fit the third category, they may be eligible for a longer registration period.

If a trust becomes required to register **after** the date of enactment of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill, new section 59C(1)(b) provides that the resident foreign trustee has 30 days to apply for registration of the foreign trust from the date the requirement to register begins.

Trusts in this category could include a foreign trust that is formed with a resident foreign trustee after the date of Royal assent or an existing foreign trust that does not have a resident foreign trustee until after the date of Royal assent. This means these foreign trusts have 30 days from the date of formation and the appointment of the first resident foreign trustee, respectively, to apply for registration.

Trustees of foreign trusts in existence with a resident foreign trustee at the time that the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill received Royal assent have until 30 June 2017 to apply for registration of the trust. This is provided for in new section 59C(1)(a).

There are differing time limits depending on whether the trust has a resident foreign trustee who is in the business of providing trustee services. The previous disclosure requirements extended the time limit if the resident foreign trustee was a new migrant who was not in the business of providing trustee services to allow them an additional two years to meet their obligations. The amended disclosure rules extend this concession in recognition of the increased disclosure requirements.

New sections 59C(3) and (4) provide that regardless of whether a resident foreign trustee is a new migrant, the time limit for application is extended when all of the trustees of a foreign trust are natural persons not in the business of providing trustee services and none of the resident foreign trustees have been resident foreign trustees before. If a person has already been a resident foreign trustee they should be aware of the obligations that this role entails.

If these requirements are met, the time limit for application is extended to four years and 30 days following the first date on which the foreign trust has a resident foreign trustee.

Example: Non-professional trustees of existing trusts

Ralph was appointed as a trustee of his friend Nora's trust on 13 January 2014. Nora is the only settlor of this trust and is not a New Zealand resident. Ralph is not in the business of providing trustee services, and as a New Zealand tax resident, he is a resident foreign trustee. Under the previous disclosure rules, Ralph was required to disclose particular information to Inland Revenue by 12 February 2014. After Royal assent of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (21 February 2017), Ralph is now required to apply for registration of Nora's trust.

Because Ralph is not in the business of providing trustee services, he is eligible for the grace period provided for by new section 59C(3). The grace period of four years and 30 days is counted from the date that Ralph became a resident foreign trustee (13 January 2014). This means Ralph has until 12 February 2018 to apply for the registration of Nora's trust.

Example: Professional trustees and newly formed trusts

Consider Frank and XYZ Trust again. XYZ Trust was formed on 1 November 2016, and Frank, a New Zealand resident, was appointed as a trustee.

XYZ's income year corresponds with the New Zealand tax year (31 March balance date).

XYZ is an existing trust at the date of Royal assent of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (21 February 2017). On the day of Royal assent Frank becomes liable to apply for registration of XYZ under section 59B(2) of the Tax Administration Act. Frank regularly serves as a trustee so the time limit applying to him is that in section 59C (1)(a) – 30 June 2017.

Information to be provided at the time of application

The previous disclosure rules required resident foreign trustees to disclose certain information on the trust:

- the name or other identifying particulars;
- name and contact details of resident foreign trustees;
- whether a settlor is resident in the Commonwealth of Australia;
- details relating to status as a qualifying resident foreign trustee (if applicable); and
- any details of which resident foreign trustee is appointed as agent for the purposes of compliance with the Tax Administration Act 1994.

The amendments in the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 update the information that must be provided at the time of registration, in line with the recommendations of the Government's April 2016 Inquiry into Foreign Trust Disclosure Rules.

Trust deed

As a starting point, section 59B(3)(a) requires that the name of the trust must be provided on application. The contact trustee must also provide a copy of the trust deed for the foreign trust (or the functional equivalent, for example, if there is no formal trust deed) along with all amending and supplementary documents (section 59B(3)(f)).

Note that a will is not a trust deed for the purposes of the foreign trust disclosure rules. However, a trust established under a will (a testamentary trust) will be a trust for these purposes.

Historical settlements

The application must also include details relating to settlements made in relation to the foreign trust (section 59B(3)(b)). These details are the date, amount, nature and settlor of each settlement.

Services provided to the trust at below market value are generally considered to be settlements, due to the broad definition of "settlement" used for the trust rules, and must be disclosed.

However, information relating to the provision of minor services at less than market value that are incidental to the activities of the trust does not need to be provided. This exclusion is intended to reduce compliance costs for trustees, and is available to both professional and non-professional trustees.

Whether a service is incidental depends on the activities undertaken by the trust and could therefore vary between trusts.

Example

John's family trust owns a property which is rented out. John's grandson mows the lawn as a favour as he lives nearby. This would be incidental to the activities of the trust.

Example

Justin's trust runs a lawn mowing business. Justin's daughter Phoebe occasionally helps by mowing lawns. This would not be incidental to the activities of the trust.

As well as being incidental to the activities of the trust, to be excluded under section 59B(3)(b), the services must also be minor. That is, the value of the services provided below market value that are incidental to the activities of the trust must also be low. This introduces a standard that applies equally to all trusts, without the additional complexities and compliance costs associated with a monetary threshold.

Section 59B(3)(b) sets three different periods for which information on settlements must be provided, depending on whether the resident foreign trustees are in the business of providing trustee services and whether the trust is formed before or after the date of Royal assent of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (21 February 2017).

If **any** of the trustees are not natural persons or are in the business of providing trustee services, then the period begins with the date of formation of the trust and ends with the application for registration. This is because professional trustees, regardless of whether they are the contact trustee, should have adequate records for the trust.

If **all** of the trustees are natural persons not in the business of providing trustee services, the period is shorter.

For trustees that become required to register a foreign trust on the date of Royal assent of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (21 February 2017) (that is, existing foreign trusts with resident foreign trustees), the trustees must provide information on settlements that date back to the later of the date of the trust's formation and 30 June 2013.

Example

Natalie and Greg's family trust was formed in April 2016 and Dan, a New Zealand tax resident, is appointed one of the trustees. All of the trustees are natural persons not in the business of providing trustee services. As part of the application for registration of the family trust, Dan must provide details of historical settlements. The later of April 2016 and 30 June 2013 is April 2016, so Dan must provide details of settlements since that date.

Example

Sam became the resident foreign trustee for a family trust when it was formed in August 2012. The later of August 2012 and 30 June 2013 is 30 June 2013. This means that at the time Sam applies for the trust to be registered, she must provide details on settlements made between 30 June 2013 and the date of her application.

If a foreign trust needs to be registered after the date of Royal assent of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (21 February 2017), the trustee must provide information on settlements that date back to the later of the trust's formation and four years prior to the date on which a trustee first becomes required to register the foreign trust. Trusts in this category could include a foreign trust that is formed with a resident foreign trustee after the date of Royal assent or an existing foreign trust that does not have a resident foreign trustee until after the date of Royal assent.

Example

John and Maraina's family trust is formed overseas in March 2019, but has no resident foreign trustee until December 2023, when Sophie, a New Zealand resident, is appointed to be one of the trustees. Sophie becomes liable to register John and Maraina's family trust when she becomes the first resident foreign trustee. Four years prior to December 2023 is December 2019, which is later than March 2019. This means that as part of the application for registration Sophie must provide details of settlements made on John and Maraina's family trust dating back to December 2019, not March 2019 (the date of formation).

The table below summarises the different periods for which details of historical settlements must be provided on application for registration.

	Start date	End date
Any of the trustees are not natural persons or are in the business of providing trustee services.	Formation of trust.	Date of application for registration.
All trustees are natural persons not in the business of providing trustee services		
Trustee becomes required to register trust on date of Royal assent (existing foreign trusts with resident foreign trustees).	Later of: • formation of trust • 30 June 2013.	Date of application for registration.
Trustee becomes required to register trust after date of Royal assent (existing foreign trusts that subsequently appoint their first resident foreign trustee, or new foreign trusts with a resident foreign trustee).	Later of: • formation of trust • four years prior to the first date on which a trustee becomes required to register the trust.	Date of application for registration.

Details about settlors, trustees and beneficiaries

In addition to information on historical settlements, section 59B(3)(c), (d) and (e) provides that the application must also include information relating to settlors, beneficiaries and trustees, as well as other persons with certain powers.

Section 59B(3)(c)(ii)–(iii) describes other persons who have specific powers in connection to the trust which allow them to have some control over the trust. Specifically these address persons who have a power to:

- appoint or dismiss a trustee, to amend the trust deed, or to add or remove a beneficiary (59B(3)(c)(ii));
- control the exercise of one of the powers mentioned above (59B(3)(c)(iii)); or
- control a trustee in their administration of the trust (59B(3)(c)(iv)).

Broadly, these powers are intended to cover the powers that a "protector" of a trust might have over the administration or control of a trust.

The information required under these sections does not vary depending on whether the trustees are in the business of providing trustee services.

The information required is summarised in the table.

Relevant person	Information to be provided
All trusts	
• Each settlor, excluding persons who only provide minor services at less than market value that are incidental to the activities of the trust (section 59B(3)(c)(i)). • Each person with a power to appoint or dismiss a trustee, to amend the trust deed, or to add or remove a beneficiary (and each person with a power to control any of these powers) (section 59B(3)(c)(ii) and (iii)). • Each person with a power to control a trustee in the administration of a trust (section 59B(3)(iv)). • Each trustee (section 59B(3)(c)(v)).	• Name • Email address • Physical residential or business address • Jurisdiction of tax residence • Taxpayer identification number • Connection with the trust.
Fixed trusts	
• Each beneficiary who is not a minor (section 59B(3)(c)(vi)). • Each nominee for a beneficiary (section 59B(3)(c)(vi)). • The parent or guardian of each beneficiary who is a minor (section 59B(3)(c)(vii)).	• Name • Email address • Physical residential or business address • Jurisdiction of tax residence • Taxpayer identification number • Connection with the trust.
• Each beneficiary who is a minor (section 59B(3)(d)).	• Name • Age • Taxpayer identification number.
Discretionary trusts	
• Each beneficiary (section 59B(3)(e)). • Each class of beneficiary (section 59B(3)(e)).	• Details sufficient for the Commissioner to determine when a distribution is made, whether a person is a beneficiary.

Section 59B(3)(c) states that a person's physical residential or business address must be provided. This means:

- for natural persons, their physical residential address; and
- for non-individuals, the business address (or registered office or servicing address).

If the email address is known to a resident foreign trustee, it must be provided to the Commissioner of Inland Revenue. If no email address is available, a contact phone number should be provided instead.

For beneficiaries of fixed trusts who are minors, the trustee must provide full contact details for each minor's parent or guardian, in addition to limited information about the minor (name, age and taxpayer identification number). A minor may not always have a taxpayer identification number, but if they do have one, it must be provided.

For the purposes of the foreign trust disclosure rules, a "minor" follows the trust tax rules and is a natural person who is under the age of 16. When a minor reaches the age of 16, the contact trustee must update the registration details held by the Commissioner. See the section "Subsequent changes to information provided on registration" for further information.

Signed declaration

As part of the application process for registering a foreign trust, section 59B(4)(c) requires the contact trustee to provide a signed declaration that each person referred to in section 59B(3)(c)(i)–(vii) has been informed of, and has agreed, to provide information necessary for compliance with the requirements relating to the provision of information regarding the trust and persons connected with the trust imposed by:

- the Tax Administration Act 1994; and
- the Anti-Money Laundering and Counter Financing of Terrorism Act 2009; and
- all regulations made under these Acts.

As part of this declaration, the contact trustee must obtain the agreement of all specified persons. If a person is incapacitated, their legal guardian, personal representative or power of attorney must provide the agreement on their behalf.

Resident foreign trustees may feel more confident that they have satisfied their statutory obligations by obtaining the signatures of the relevant persons as proof of their agreement.

The declaration was a specific recommendation of the Government Inquiry into Foreign Trust Disclosure Rules and ensures that all persons have turned their minds to the relevant laws and regulations that they will need to comply with.

If any of the persons specified in section 59B(3)(c)(i)–(vii) are deceased, section 59B(4)(a) provides that in the signed declaration, the contact trustee should state that the agreement cannot be obtained as the person is deceased.

If a person cannot be located, section 59B(4)(b) provides that the contact trustee should include in the signed declaration an outline of their attempts to find the person.

If incorrect information is disclosed to Inland Revenue as part of the registration or ongoing disclosure processes, including as part of the signed declaration, the resident foreign trustee could have penalties imposed under Part 9 of the Tax Administration Act 1994. For example, knowledge offences apply for knowingly providing incorrect information required under tax laws. Evasion offences may also apply.

Subsequent changes to information provided on registration

Following the registration of a foreign trust, if there are any changes to the information provided on registration as set out in section 59B(3), section 59B(5) requires the contact trustee to inform the Commissioner of Inland Revenue of the changes and provide a signed declaration required under section 59B(4) for the alteration or addition.

New section 59C(2) requires the contact trustee to provide this updated information to the Commissioner of Inland Revenue within 30 days of becoming aware of the change.

Example

The Troy Trust is a registered foreign trust. After registration, Ed becomes a settlor. The contact trustee must provide to the Commissioner of Inland Revenue, Ed's details including his email address, physical residential address, where he is tax resident and his taxpayer identification number. The contact trustee must also provide an updated signed declaration that Ed has been informed of, and has agreed to provide information necessary for compliance with, the requirements relating to the provision of information relating to the trust and persons connected with the trust imposed by the Tax Administration Act 1994, and the Anti-Money Laundering and Counter Financing of Terrorism Act 2009 and all regulations made under these Acts.

Annual disclosure returns and financial statements

An ongoing requirement for the contact trustee following the registration of a foreign trust is to prepare an annual return for the foreign trust and send it to the Commissioner of Inland Revenue. This is set out in new section 59D.

Section 59D(2) states that the annual return must be in a form prescribed by the Commissioner of Inland Revenue and must include the following.

Information	Detail
Financial statements for the trust for the return year (section 59D(2)(a)).	If the trustee prepares financial statements or is required to prepare financial statements.
Settlements made on the trust in the return year, excluding the provision of minor services incidental to the activities of the trust (section 59D(2)(b) and (c)).	Each settlement: • date • nature • amount • settlor's name • settlor's email address • settlor's physical residential or business address • settlor's jurisdiction of tax residence • settlor's taxpayer identification number.

Distributions to beneficiaries made during the return year (section 59D(2)(d) and (e)).	Each distribution: • date • amount • nature • beneficiary's name • beneficiary's email address • beneficiary's physical residential address • beneficiary's jurisdiction of tax residence • beneficiary's taxpayer identification number. If the beneficiary is a minor: • minor's age • minor's jurisdiction of tax residence • minor's taxpayer identification number • parent or guardian's name • parent or guardian's email address • parent or guardian's physical residential address • parent or guardian's jurisdiction of tax residence • parent or guardian's taxpayer identification number.

At the time of registration, the contact trustee for a foreign trust must provide information about settlements made on the trust before the trust's registration. To ensure that the information held by the Commissioner of Inland Revenue is kept up to date, subsequent settlements must be reported in the annual return. Consistent with the disclosure of historical settlements, information relating to the provision of minor services at less than market value that are incidental to the activities of the trust does not need to be provided. Also see the section "Information required on registration".

Likewise, detailed information about distributions made during the return year need to be included in the annual return. This includes identifying information about beneficiaries, in line with the information provided at the time of registration.

Financial statements

As noted above, section 59D(2)(a) requires that if the trustee of a foreign trust prepares financial statements or is required to prepare financial statements, these must be provided with the annual return. The intent is that even if a trust does not prepare financial statements for other purposes, they must prepare financial statements in order to meet their obligations under the foreign trust disclosure requirements.

An Order in Council will be made under section 21C of the Tax Administration Act 1994 to specify the minimum standards for financial statements for foreign trusts. The Order in Council will make it clear for foreign trusts, including those that do not ordinarily prepare financial statements, what information must be provided.

Due dates

Section 59D(3) requires the annual return, including the financial statements, to be filed with the Commissioner of Inland Revenue within six months after the trust's balance date, or by 30 September if the trust does not have a balance date (which is six months after the end of the tax year). This should allow resident foreign trustees adequate time to gather required documentation and meet their obligations, as it is acknowledged that much of the information may be held overseas.

Annual returns must be provided for every year that includes a period which the foreign trust is registered, or is required to register under section 59B. However, a transitional rule in section 59D(1)(c) allows resident foreign trustees who become liable to register a trust on the date of enactment, to file returns only for years that begin after 31 March 2017.

No additional time is provided to non-professional trustees, or those with tax agents.

Fees

At the time an application for registration is lodged or an annual return is filed, a resident foreign trust must pay the registration fee or annual return fee, as prescribed in sections 59B(2) and 59D(1).

The fees are set out in new section 59E. Section 59E(1) provides that the Governor-General may, from time to time, make regulations prescribing either of these fees.

However, until the first regulation has been made under section 59E(1), the fees are set at:

- $270 (including goods and services tax) for an application for the registration of a foreign trust; and
- $50 (including goods and services tax) for an annual return for a foreign trust and a return year.

A number of concessions have been introduced into the foreign trust disclosure rules for non-professional trustees. In line with other concessions relating to the period for registration and the provision of historical settlements, section 59E(5) allows an exemption from both the registration fee and annual return fee for resident foreign trustees who are natural persons not in the business of providing trustee services. To be eligible for this exemption, all resident foreign trustees of the foreign trust must be natural persons not in the business of providing trustee services.

Information sharing with other agencies

Information sharing with domestic enforcement agencies

Section 81 of the Tax Administration Act 1994 has been amended to add a new subsection 81(4)(z). Section 81(4) contains exceptions to the tax secrecy rules and allows Inland Revenue to share specified information.

New subsection 81(4)(z) specifically allows Inland Revenue to share information relating to the registration or the absence of registration of a foreign trust with the Department of Internal Affairs and the New Zealand Police. This will enable Inland Revenue to share its register of foreign trusts with the Department of Internal Affairs and the New Zealand Police. This follows a specific recommendation of the Government Inquiry into Foreign Trust Disclosure Rules.

In addition, information collected under the amended disclosure rules will be shared with the Overseas Investment Office once an agreement is in place.

Information sharing with tax treaty partners

Inland Revenue is also able to share information internationally with its tax treaty partners under exchange of information arrangements (double tax agreements, tax information exchange agreements, and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters). Inland Revenue can provide information in relation to foreign trusts to other tax authorities under exchange of information agreements if relevant parties (for example, settlors and beneficiaries) are resident in those jurisdictions.

However, it is important to note that Inland Revenue is not obligated to send foreign trust information to jurisdictions with which it has a tax treaty if it believes there is a risk in how that information will be used or disclosed.

Exchange of information articles in tax treaties contain restrictions on what the information exchanged can be used for. These articles provide that a jurisdiction is not obligated to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or any information if its disclosure would be contrary to public policy.

Further, exchanged information can only be disclosed to specific persons, and can only be used by those persons for specified purposes.

Consequential amendments

A number of sections have been repealed or amended.

In the Income Tax Act 2007, section HC 26(2), (3), and (4) has been repealed as section HC 26 has been substantially rewritten.

The definitions of "settlement" and "settlor" have been repealed from section 3(1) of the Tax Administration Act 1994. They are identical to the definitions provided in section YA 1 of the Income Tax Act 2007, so a specific definition is not necessary due to the operation of section 3(2) of the Tax Administration Act 1994.

The definition of "qualifying resident foreign trustee" has also been repealed as it was a feature of the previous foreign trust disclosure rules that was not retained.

SIMPLIFIED BUSINESS TAX PROCESSES

Sections DF 4, LB 7, LB 8, MD 9, RD 3, RD 8, RD 10, RD 10B, RD 18, YA 1, and schedule 4 of the Income Tax Act 2007; sections 24G, 24L, 24LB, 24LC, 24M, 35, 120C, 120KB, 120KBB, 120KE, 120VC, 138E, 139B, 139BA, 139C, 142A, 142B, 173L, 173M, 173S, 183C of the Tax Administration Act 1994

Changes have been made to the business tax rules following enactment of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill on 21 February 2017.

This *Tax Information Bulletin* item covers changes that:

- modify the application of use-of-money interest (UOMI) for taxpayers who make all but their last instalment of provisional tax using the standard "uplift" method;
- increase the safe harbour from UOMI from $50,000 to $60,000 of residual income tax and extend the safe harbour to non-individual taxpayers;
- allow contractors subject to the schedular payment rules to elect their own withholding rate;
- extend the schedular payment rules to contractors who work for labour-hire firms;
- allow contractors not covered by the schedular payment rules to enter voluntary withholding agreements;
- prevent taxpayers from transferring tax to an earlier period that exceeds the amount in debt or in dispute in that period, and to clarify when UOMI starts and when a transfer takes effect for GST refunds and GST overpayments;
- enable the Commissioner to offset any credits or refunds the taxpayer has against the taxpayer's tax liability arising from a new or increased assessment by the Commissioner;
- confirm that information required under a prescribed form can be provided verbally when the Commissioner of Inland Revenue considers it to be appropriate;
- enable Inland Revenue to continue to administer the late payment penalty grace period during the period in which tax types are transitioned between Inland Revenue's old FIRST system and new START software system; and
- modify the cancellation of interest rules, in certain circumstances.

Safe harbour for all taxpayers using the standard provisional tax method

Amendments have been made which modify the application of UOMI to taxpayers who make all but their last instalment of provisional tax using the standard method (commonly known as the standard "uplift" method). For these taxpayers, UOMI will no longer apply from the first instalment. Instead, it will commence from the date of the final instalment of provisional tax.

Background

Under the previous rules, taxpayers who used the standard method for paying provisional tax but exceeded the safe harbour threshold of $60,000 of residual income tax were liable to UOMI from the first instalment when their residual income tax for that instalment differed from the amount paid.

For taxpayers who cannot reasonably estimate their income (such as taxpayers with volatile or seasonal income) and who use the standard method, the previous rule could be unfair as provisional tax assumes a straight-line earning of income throughout a year.

A new rule has been introduced, so that if a taxpayer makes all their provisional tax instalments (except for the final instalment) using the standard method on the respective payment dates, UOMI will only apply from the date of the final instalment on the difference between the residual income tax and the payments made.

This change was announced by the Government in a pre-Budget release in April 2016 and the proposals consulted on in an officials' issues paper, *Making Tax Simpler – Better Business Tax*, released in April 2016.

Feedback following consultation at the select committee stage of the Bill resulted in some changes to the technical detail of the legislation but did not alter the policy intent of the original proposal.

Key features

For taxpayers who pay their provisional tax using the standard method and who do not qualify for the safe harbour, UOMI will only apply from the date of the final instalment when:

- the taxpayer has made all of their instalments (other than the final instalment) using the standard method;
- has paid those instalments on or before the due date;

NEW LEGISLATION

- any provisional tax associates have also used the standard method for all of their instalments (other than the final instalment); and
- there is no provisional tax interest avoidance arrangement.

For taxpayers using the standard method who do not meet the above criteria, UOMI will apply from the applicable instalment date on the *lesser* of the difference between:

- the amount of residual income tax apportioned to the particular instalment date and the amount paid by the taxpayer; or
- the amount of the standard method instalment for the particular instalment date and the amount paid by the taxpayer.

A "provisional tax associate" of a person (person A) is defined as follows:

- If person A is a company, another company in the same wholly owned group as person A is a "provisional tax associate".
- If person A is a company, another person who has a direct or indirect shareholding interest in the company greater than 50 percent is a "provisional tax associate".
- If person A is not a company or is a company acting as a trustee, another person in which person A has a direct or indirect shareholding interest greater than 50 percent is a "provisional tax associate".

A provisional tax avoidance arrangement is an arrangement involving the manipulation of one or more amounts of residual income tax, including a zero amount of residual income tax, with the purpose or effect of defeating the intent and application of the UOMI provisions. It is intended to capture situations when taxpayers who are outside the "provisional tax associate" definition manipulate income between parties to avoid application of the UOMI rules. It is intended to apply only in cases of clear manipulation to remove parties from the UOMI rules.

Application date

The new UOMI rules for standard method taxpayers in section 120KBB of the Tax Administration Act 1994 apply for the 2017–18 and later income years.

Detailed analysis

A comprehensive UOMI regime applies to all provisional taxpayers who do not fall within a specified safe harbour. Where a taxpayer's residual income tax apportioned over the number of provisional tax instalment dates differs from the amounts paid by the taxpayer, over- or underpaid tax will arise and UOMI will apply to the difference. This applies even if a taxpayer has made the required instalments under the standard method.

The standard method calculates instalments of provisional tax based on 105 percent of the prior year's residual income tax liability or 110 percent of the year preceding the prior year depending on whether the taxpayer has filed their tax return for the prior year.

Example 1

Wooley Shearers Limited (Wooley) provides shearing services to farmers. The company has difficulty estimating its provisional tax for the year as it charges by the weight of the wool and the amount of income derived depends on the growing rate of the sheep. In the 2017 income year Wooley has residual income tax of $260,000. Wooley has filed its 2017 tax return prior to the first instalment of provisional tax and decides to pay its 2018 provisional tax using the standard method. This will require it to pay three instalments of $91,000, which it does on the respective dates.

Because of ideal wool-growing conditions, Wooley has a standout 2018 year and at the end of the year Wooley calculates its residual income tax as $390,000. This means that Wooley should have paid instalments of $130,000. Wooley will be charged UOMI on the difference between the instalments calculated by reference to its residual income tax and what it paid, being $39,000 ($130,000 – $91,000) for each instalment until the amount of the underlying tax and UOMI is paid.

New section 120KBB of the Tax Administration Act 1994 provides a new method for applying UOMI for most standard method and some estimation method provisional taxpayers.

The effect of the changes is that when a taxpayer pays the required instalments of provisional tax (excluding the final instalment) based on the standard method amount, no UOMI will apply to any over- or underpayment of tax until the due date for the final instalment.

Example 2

Assuming the same facts for Wooley above, the new rules in section 120KBB will apply to Wooley because it paid its first two instalments based on the standard method on time, and assuming all the other requirements of section 120KBB are met, UOMI will still apply to Wooley because it has underpaid its tax at the final instalment date. However, it will only apply from that date on the difference between Wooley's residual income tax for the year and the amount paid to the final instalment date.

This means UOMI will be charged on the difference between $390,000 and $273,000, being $117,000, from the final instalment date until the underlying tax and applicable UOMI is paid.

This means that a taxpayer who makes all their instalments (other than the final instalment) using the standard method and makes a final instalment which covers their residual income tax for the year will pay no UOMI for the year. Given the final instalment for provisional tax is some time after balance date it, should be possible for taxpayers to determine with reasonable accuracy their tax liability for the year and avoid the application of UOMI by topping up any shortfall in tax paid by the final instalment.

Example 3

Wooley again uses the standard method in the 2019 income year and under that method is required to make 3 instalments of $136,500 ((105 percent of $390,000)/3). It makes the first two instalments on time but just before the due date for the third instalment Wooley calculates that it has had another spectacular year and its residual tax liability for the year is actually $650,000. This means it should have made instalments of $216,667. Wooley decides not to pay the final instalment based on the standard method amount but rather makes a payment based on its estimate of its final tax liability for the year. Wooley makes a payment of $377,000 on the due date for the final instalment.

When Wooley completes its tax return for the 2019 year it calculates its final tax liability for the year as $655,000. As Wooley has underpaid its tax for the 2019 income year it will be charged UOMI. Because Wooley has made all its instalments (other than the final instalment) using the standard method, and assuming all the other requirements of section 120KBB are complied with, Wooley will only be charged UOMI from the date of the final instalment until the tax and any UOMI is paid on the difference between Wooley's residual income tax and the amount paid: $5,000 ($655,000 – $600,000).

Who can use the new rules?

A taxpayer must be an interest concession provisional taxpayer to use the new rules. This means they must be liable to pay provisional tax and:

- use one of the standard methods described in section RC 5(2) or (3) of the Income Tax Act 2007 for the tax year (commonly known as the "uplift" method); or
- use the estimation method described in section RC 5(5) but their payments of provisional tax on or before the instalment dates for the tax year other than the final instalment are not made under the estimation method and are equal to the amounts under the standard method.

Essentially this means the person either uses the standard method for all of their instalments or the standard method for all instalments except the final one, which they estimate. This allows a person to estimate an amount higher or lower than the standard uplift at the final instalment date to account for actual results during the year. Given the final instalment is after the end of the income year, a reasonable level of accuracy should be able to be applied to this final instalment to minimise any UOMI.

In addition, all provisional tax associates of the taxpayer must either be interest concession provisional taxpayers or use the GST ratio method for provisional tax, and there cannot be a provisional tax interest avoidance arrangement. Both definitions are discussed below.

What if a taxpayer does not pay the instalment due?

If a taxpayer does not pay the standard method instalments, UOMI will apply from the applicable instalment date on the lesser of:

- one-third[26] of the amount of residual income tax for the year less the amount paid; or
- the standard method instalment amount for the relevant instalment, less the amount paid.

This will also apply when a particular instalment is paid late.

[26] Or other portion where the number of instalments is not three.

The rule also differs from the previous rule, which charged UOMI on the difference between residual income tax and the amount paid for a particular instalment date.

Example 4

Thomas Water Finders Limited (TWFL) is a consulting firm that provides consulting services to the agricultural sector in the use of beavers to assist in water irrigation for farmers in drought affected areas. TWFL has a March balance date. As beavers are not yet permitted into New Zealand, a lot of TWFL's time is spent lobbying the Government to permit the introduction of beavers to New Zealand. Once the Government permits introduction of the rodents to New Zealand TWFL expects its income earning to skyrocket as farmers see the benefits that using beavers as natural irrigators can have, based on experience in Nevada where beavers are used to provide natural irrigation.

In the 2018 income year TWFL had residual income tax liability of $55,000. Because of the uncertainty of the future of this innovative irrigation method, TWFL decides to use the standard method to pay provisional tax for the 2019 income year. It calculates it is required to make three instalments of $19,250 ((105%x$55,000)/3). TWFL pays its first instalment on time but between the first and second instalment dates the Government approves the introduction of beavers for irrigation schemes in New Zealand and TWFL's workload increases dramatically. Because of this TWFL forget to make their second provisional tax instalment.

At the date of the third instalment, TWFL realises it has missed the second instalment and also calculates that because of the massive increase in consulting revenue its year-end tax liability is expected to be $1,250,000. TWFL wants to minimise the impact of UOMI and so, on the final instalment date, the company makes a payment based on the estimate of its final tax liability of $1,231,239. This is made up of the tax owing ($1,230,750) and $489 for UOMI on the second instalment.

When it completes its tax return, TWFL calculates its final tax liability as $1,250,000, as it expected. Because TWFL did not make its second instalment on time it cannot use the concessionary rule in section 120KBB(2) for the missed instalment but instead must use the rule in section 120KBB(3) in relation to the missed instalment.

This will require the company to pay UOMI on the lesser of:

(a) 1 divided by the number of instalment dates for the income year multiplied by its residual income tax less the amount paid in relation to the instalment ((1/3x$1,250,000) -0 = $416,667); or

(b) the amount the company is liable to pay in accordance with the standard method for that particular instalment ($19,250).

The lesser of these amounts being (b), TWFL will be charged UOMI on $19,250 from the due date of the second instalment until the date that the tax and applicable UOMI is paid, which was the date of the third instalment ($489). TWFL may also be subject to late payment penalties.

Who is a provisional tax associate?

Under new section 120KBB all provisional tax associates of a taxpayer who wish to use the rules in section 120KBB are required to be an "interest concession provisional taxpayer" themselves or use the GST ratio method to calculate provisional tax. This is an anti-avoidance provision to stop related parties switching income between themselves to avoid the application of the UOMI rules.

Example 5

De Jong Limited (DJ) is a consulting firm owned by Jeff Jazzy. Jeff undertakes all the work for DJ as a shareholder-employee and payments from DJ to him are not subject to PAYE. In the 2016 year DJ has residual income tax (RIT) of $70,000 as all the income was held in the company that year. Jeff had no residual income tax.

Over the next two years, assuming the same income level, but shifting it between DJ and Jeff, and alternating provisional tax calculation methods, no provisional tax is paid by either party, and there is no exposure to UOMI if the RIT is paid by the final instalment:

Year	**2017**			**2018**		
	Method	*Prov amount*	*RIT*	*Method*	*Prov amount*	*RIT*
DJ	Estimate	Nil	Nil	Standard	Nil	$70,000
Jazzy, Jeff	Not liable	N/A	$70,000	Estimate	Nil	Nil

NEW LEGISLATION

The rule will only apply to persons who are provisional tax associates of the person wishing to use the rules in section 120KBB. A "provisional tax associate" of person A is defined as follows:

(i) If person A is a company, another company in the same wholly owned group of companies as person A is a "provisional tax associate".

(ii) If person A is a company, another person that is associated with person A under section YB 3 of the Income Tax Act 2007, treating section YB 3 as requiring 50 percent voting interests and market value interests instead of 25 percent, and ignoring section YB 3(3) and (4) (commonly known as the tripartite test), is a "provisional tax associate".

(iii) If person A is not a company or is a company acting as a trustee, another person that is associated with person A, treating section YB 3 of the Income Tax Act 2007 as requiring 50 percent voting interests and market value interests instead of 25 percent and also ignoring section YB 3(3) and (4) is a "provisional tax associate".

This definition will essentially capture wholly owned group companies and those who have, directly or indirectly, a 50 percent or greater share in a company.

Example 6

Charger Limited (Charger) is owned equally and run by its two shareholders Macintyre and Alistair Craig. Both draw shareholder-employee salaries from the company from which no PAYE is deducted. Charger wishes to use the concessionary rules in section 120KBB. All provisional tax associates must also be "interest concession provisional taxpayers".

As Macintyre and Alistair own 50 percent of the voting interest in Charger they will be required to be interest concession provisional taxpayers or use the GST ratio method to calculate provisional tax.

Example 7

Morrissey Limited (Morrissey) is a procurement consulting company owned equally by four university friends who are not related. All the owners draw shareholder-employee salaries from the company from which no PAYE is deducted. Morrissey wishes to use the concessionary rules in section 120KBB. All provisional tax associates must also be interest concession provisional taxpayers or use the GST ratio method.

As none of the four shareholders own 50 percent of the voting interest in Morrissey it can use the concessionary rules no matter what provisional tax method the shareholder-employees use.

Example 8

Coronet Super Bee Limited (CSBL) produces honey from a special breed of bee. It has two subsidiary companies, Hummer Limited (Hummer) that operates the hives and Bel Air Limited (Bel Air) that bottles the honey. Hummer is 100 percent owned by CSBL but Bel Air is only 50 percent owned by CSBL with the other 50 percent owned by Pacer Limited, another honey producer who is unrelated to CSBL.

Hummer would be required to be an interest concession taxpayer or use the GST ratio method to calculate its provisional tax for CSBL to use the concessionary rules in section 120KBB.

What is a provisional tax interest avoidance arrangement?

To be able to use the concessionary rules in section 120KBB there cannot be a *provisional tax interest avoidance arrangement* in relation to the person. This is defined in section 120KBB(4)(b) as being an arrangement involving the manipulation of one or more amounts of residual income tax, including a zero amount of residual income tax, with the purpose or effect of defeating the intent and application of the interest rules.

This is designed to capture the situation where related taxpayers manipulate income between entities to avoid the application of UOMI. It is expected that most of the opportunity to defeat the intention of the UOMI rules has been sufficiently dealt with in the requirement that provisional tax associates use the same provisional tax method. However, there may be some cases that will sit outside that provision, where manipulation occurs.

Example 9

Assume the same facts for the Morrissey Limited (Morrissey) example. As above the shareholders of Morrissey are not caught by the provisional tax associate rule. During the 2018 income year Morrissey uses the standard method to calculate its provisional tax liability. In the 2017 year Morrissey used the last of its prior year tax losses, which resulted in a residual income tax liability of $20,000 for the company.

The shareholders meet and agree that for the 2018 year they will leave all the profits of the business within the company and will not take any shareholder salaries for the year. Morrissey pays its provisional tax instalments based on the standard uplift of $7,000 for each of the first two instalments. Prior to the third instalment it calculates its residual income tax for the year to be $240,000. It pays a final instalment on that estimated amount of $226,000. As it meets all the requirements of section 120KBB, UOMI will only apply on any unpaid tax at the final instalment.

When Morrissey completes its 2018 tax return it calculates its residual income tax as $240,000 and no UOMI is payable. No provisional tax is payable by the four shareholders for the 2018 year.

For the 2019 year the shareholders meet and agree that for the 2019 year they will pay out all the profits of Morrissey to the shareholders via shareholder salaries, which are not subject to PAYE. For the 2019 income year Morrissey estimates its provisional tax liability at zero. The shareholders are not liable for provisional tax. At the end of the 2019 income year the shareholders calculate that they each have residual income tax of $70,000 each. The shareholders are able to use the concessionary treatment in section 120KBB and pay the total amount of tax due by the due date for the final instalment.

For the 2020 year the shareholders meet and agree to reverse the 2019 position and leave all the income in the company and receive no shareholder salaries. The shareholders estimate their provisional tax liability at zero and Morrissey is not liable to pay provisional tax. Again the result is no provisional tax paid and no UOMI payable by the shareholders or the company. This essentially mirrors the situation described in the De Jong example above.

There are no commercial reasons for the switching of income between the parties other than to avoid the application of the UOMI rules. This situation is likely to be treated as a provisional tax interest avoidance arrangement and the rules in section 120KBB will not apply to any of the income years in question.

Example 10

Cowan Mattresses Limited (Cowan) has a residual income tax liability for the 2018 year of $100,000. It decides to use the standard method due to a volatile market in the mattress industry. Cowan's 2019 provisional tax liability will be $105,000 with $35,000 being due at each instalment date.

The owner of Cowan, Matt, owns another company called Cowan Mattresses (2019) Limited. This company has a slightly different shareholder structure and is not in a 100 percent wholly owned group with Cowan and is therefore not a provisional tax associate of Cowan Mattresses (2019) Limited.

Matt then makes an estimate of Cowan's income tax liability to zero. All new mattress sales are put through Cowan Mattresses (2019) Limited during the 2019 year. At the time for the final instalment of provisional tax Cowan Mattresses (2019) Limited calculates that it has residual income tax of $130,000, which it pays on the date of the final instalment. Its 2019 tax return confirms that its residual income tax is $130,000 for the year and Cowan Mattresses (2019) Limited is charged no UOMI as it otherwise meets the requirements of section 120KBB. Cowen has no income for the year and has no residual income tax for the 2019 income year.

In the 2020 year Cowan Mattresses (2019) Limited decides to estimate its residual income tax as zero. Matt then books all mattress sales in Cowan for the 2020 income year. Again both entities pay no provisional tax for the year.

As there is no commercial reason for the structuring of the business in this way, and the effect of the structuring is that no UOMI is paid by the entities (along with no provisional tax), it is likely this situation would be considered a provisional tax interest avoidance arrangement and section 120KBB would not apply.

Can I make payments into a tax pool and still use the rules in section 120KBB?

Tax pooling is a mechanism to facilitate the payment of tax while reducing the impact of UOMI by allowing taxpayers to swap tax payments between those taxpayers who are overpaid and those who are underpaid.

The new rules in section 120KBB are related to the calculation of UOMI. The overlay of tax pooling does not change the application of the rules and taxpayers can still use tax pooling and take advantage of the new UOMI calculation rules as long as the criteria in section 120KBB are met.

Example 11

eWong Limited (eWong) is an advisor to e-commerce retailers, advising them on the security of payment methods. eWong is owned by Enia who has difficulty determining eWong's tax liability for the year because of the uncertainty of income. She has previously used a tax pooling intermediary to facilitate the payment of eWong's provisional tax liabilities. Enia sees value in using a tax pool as inevitably she finds that eWong's provisional tax paid does not match its final tax liability no matter how hard she tries to estimate the earnings of the company for the year. Using the tax pool reduces her cost of UOMI when the estimate is understated and maximises credit UOMI when she ends up overpaying.

Enia sees advantages in using the new rules in section 120KBB but has an existing relationship with the tax pooling intermediary she uses and wishes to continue doing that.

For the 2018 year eWong's residual income tax is $78,000, which means that if eWong wants to use the standard uplift method for its 2019 income year it will need to make three instalments of $27,300. It pays the first two instalments into the tax pooling intermediary on the due dates. On the date of the final instalment Enia calculates that eWong's residual income tax for the 2019 income year is $100,000 so she decides to make a payment to the tax pool of the balancing amount of $45,400.

Within the time permitted to make transfers from the tax pool Enia requests that the pooling intermediary make transfers to the income tax account of eWong Limited of $27,300 at the first and second provisional tax dates and $45,400 on the final instalment date.

Assuming eWong meets all the other requirements of section 120KBB eWong will not be charged any UOMI as it has paid its tax liability for the year by the third instalment and has made the required payments under the standard method for the first two instalments.

Does credit UOMI apply to overpayments?

The concessionary rules contained in section 120KBB reduce the impact of UOMI on taxpayers by delaying the impact of UOMI until the final instalment date, which is after the end of the income year.

To be consistent with that, no UOMI is payable by Inland Revenue until the date of the final instalment. New section 120VC specifically provides for this. Taxpayers who use the concessionary rules in section 120KBB will have no credit interest paid to them in respect of overpayments until the date of the final instalment.

Example 12

Mack Limited is a manufacturer of raincoats. Mack has historically had a very seasonal business in that it tends to sell more raincoats during the winter months but due to climate change, the demand for raincoats is extremely unpredictable, which makes estimating the income of the company very difficult.

Mack has been using the standard method as the owner, Steve, finds it is the best estimation of income that he can make because of this unpredictability. However, even using the standard method Steve often finds that Mack ends up paying or receiving UOMI because of its residual income tax not matching with the standard method payments. Steve thinks the changes to section 120KBB will help Mack as it will ensure there is no exposure to UOMI.

In the 2017 year Mack has residual income tax of $847,000. It has not filed its 2018 return as yet so calculates its 2019 provisional tax based on 110 percent of the 2017 residual income tax. This will mean that Mack must make three instalments of $310,567 under the standard uplift.

Mack makes the first two instalments on that basis on time and when it gets to the third instalment Steve has a good idea of what the final residual income tax for Mack will be for the year. Unfortunately Mack has not had a good year, with rainfall at an all-time low. Steve calculates the residual income tax for Mack at the final instalment date to be $250,000. This means that Mack has overpaid its provisional tax for the year. At the final instalment date Mack estimates its provisional tax liability to be $250,000. It also requests a refund of the overpaid provisional tax from Inland Revenue, which it receives two months after the final instalment date.

When Mack files its 2019 income tax return the final residual income tax liability is $250,000. It is assumed that Mack meets all the other requirements of section 120KBB. Because Mack paid its total residual income tax by the final instalment date, no UOMI would be payable by Mack. In addition, although to the third instalment date Mack has overpaid its tax for the year, it will only receive credit UOMI from the final instalment date until the date the amount of the overpayment is refunded (that is, two months after the final instalment date).

Safe harbour from use-of-money interest

Amendments have been made that modify the existing safe harbour from UOMI. The changes increase the safe harbour from $50,000 to $60,000 of residual income tax and extend the safe harbour to non-individual taxpayers.

Background

Section 120KE of the Tax Administration Act 1994 contains a safe harbour for taxpayers from the application of UOMI. Under the previous rules, to qualify for the safe harbour, the taxpayer had to comply with the following requirements:

- be a natural person, other than in their capacity as a trustee;
- have residual income tax less than $50,000 for the tax year;
- not have estimated their residual income tax under section RC 7 of the Income Tax Act 2007;
- not have used a GST ratio under section RC 8 in the tax year to determine their provisional tax payable for the tax year; and
- not at any time in the tax year held an RWT exemption certificate under section 32I of the Tax Administration Act 1994.

The taxpayer's residual income tax would then be due and payable in one instalment on their terminal tax date.

This means no UOMI would be payable by the taxpayer for the tax year notwithstanding they may have underpaid their liability at one or more instalments.

Changes in the new Act modify this rule.

Key features

The modifications to the current safe harbour rule:

- increase the threshold to use the safe harbour for a taxpayer's residual income tax from $50,000 to $60,000;
- extend the safe harbour to non-individual taxpayers;
- ensure that taxpayers using the safe harbour have paid the instalments required;
- remove the current requirement that the taxpayer cannot use the safe harbour when they have an RWT exemption certificate issued under section 32I; and
- introduce a new anti-avoidance provision to the safe harbour.

The safe harbour rule is designed to alleviate the impact of UOMI for those taxpayers who have relatively small amounts of residual income tax. This concession has previously only been available to natural persons. The changes extend the safe harbour to non-individuals and increase the threshold to residual income tax of less than $60,000. To prevent non-individuals from manipulating incomes between related parties, a new anti-avoidance provision has been introduced to protect against gaming of the safe harbour.

There has also been a consequential amendment to the definition of "initial provisional taxpayer" in section YA 1 of the Income Tax Act 2007 to reflect this change.

Application date

The amendments to the safe harbour rule in section 120KE(1) apply for the 2017–18 and later income years.

Detailed analysis

Section 110 of the new Act modifies the application of the safe harbour by modifying section 120KE(1) of the Tax Administration Act 1994.

It replaces section 120KE(1)(a), removing the requirement for the taxpayer to be a natural person but requiring that the taxpayer to make all instalments required under sections RC 3(3), RC 9 and RC 10 of the Income Tax Act 2007.

Subsection 110(2) replaces $50,000 with $60,000 in section 120KE(1)(b) increasing the threshold for residual income tax to use the safe harbour from $50,000 to $60,000.

Subsection 110(3) introduces the anti-avoidance provision which requires that there is no provisional tax interest avoidance arrangement in relation to the taxpayer.

A provisional tax interest avoidance arrangement is defined in new section 120KBB of the Tax Administration Act as an arrangement involving the manipulation of one or more amounts of residual income tax, including a zero amount of residual income tax, with the purpose or effect of defeating the intent and application of the interest rules within the Tax Administration Act.

Subsection 110(3) also removes the current requirement in section 120KE(1)(e) that restricts taxpayers who have a RWT certificate of exemption issued under section 32I from using the safe harbour.

When the safe harbour applies

The amended safe harbour rule in section 120KE(1) provides that a provisional taxpayer's residual income tax for a tax year is due and payable in one instalment on their terminal tax date if:

- they have paid all instalments under one of the standard methods described in section RC 5(2) or (3) of the Income Tax Act 2007 on or before the instalment dates in accordance with sections RC 9 and RC 10 or they have no obligation to pay provisional tax under section RC 3(3);
- their residual income tax is less than $60,000 for the tax year;
- they have not estimated their residual income tax under section RC 7 of the Income Tax Act 2007 for the tax year;
- they have not used a GST ratio method under section RC 8 of that Act in the tax year to determine the amount of provisional tax payable for the year; and
- there is no provisional tax interest avoidance arrangement in relation to the person.

Example 13

Leroy is a provisional taxpayer for the 2018 income year who uses the standard method. He is required to make three instalments of $10,000 during the year, which he does on the applicable due dates. When Leroy completes his tax return he discovers that his residual income tax for the year is $57,000. He has underpaid his provisional tax for the year. However, because Leroy has paid all three instalments on the due dates, his residual income tax is less than $60,000, he has not estimated or used the GST ratio method and there is no provisional tax avoidance arrangement in relation to Leroy, section 120KE (1) will deem his residual income tax to be due and payable in one instalment on his terminal tax date. He will not have any UOMI exposure until that date.

Example 14

Shoshanna is a provisional taxpayer for the 2018 income year. Under the standard method she is required to make three instalments of $10,000 on 28 August 2017, 15 January 2018 and 7 May 2018. She makes the following payments during the year:

28 August 2017	$9,000
15 January 2018	$8,000
7 May 2018	$28,000

When she completes her tax return for the year Shoshanna calculates she has a residual income tax of $45,000.

Because Shoshanna did not make the required payments under the standard method on the instalment dates she is not able to use the safe harbour and will be subject to UOMI and may also be subject to late payment penalties on the same basis.

Example 15

Tanks-R-Us Limited is a small business that manufactures and sells earthquake water storage tanks to consumers. It was not liable for provisional tax in the 2016–17 year as it had tax losses for the year. Because of an upturn in demand for tanks in the 2017–18 income year, when Tanks-R-Us completes its 2018 tax return it calculates it has a residual income tax of $59,500. Tanks-R-Us is deemed to be a provisional taxpayer for the 2018 tax year under section RC 3. However, because the company has residual income tax of less than $60,000, and it was not required to make any provisional tax instalments for the year under section RC 3(3), it will fall within the safe harbour and its residual income tax will be due and payable on its terminal tax date with no exposure to UOMI until that date.

Provisional tax interest avoidance arrangement

A provisional tax interest avoidance arrangement is defined in section 120KBB(4) of the Tax Administration Act 1994 as an arrangement involving the manipulation of one or more amounts of residual income tax, including a zero amount of residual income tax, with the purpose or effect of defeating the intent and application of the interest rules in Part 7 of the Tax Administration Act 1994.

It is intended that this provision will apply to the most egregious of cases where a taxpayer has manipulated the flow of income to avoid application of the interest rules and take advantage of the safe harbour. It will not apply when normal commercial transactions result in taxpayers being within the safe harbour concession.

Example 16

Aroha works as a self-employed computer consultant. She also owns 100 percent of a company that undertakes interior design for domestic clients, Inside Out Limited. Aroha operates the interior design business in her spare time, usually on weekends.

Both Aroha and Inside Out Limited make provisional tax payments using the standard method. For the 2017–18 income year both taxpayers make the required standard uplift instalments on the applicable due dates. When they file their tax returns Aroha has $58,700 and Inside Out Limited $59,670 of residual income tax. These two operations are clearly run separately and there has been no manipulation of income so there will be no provisional tax interest avoidance arrangement and both entities will be within the safe harbour.

Example 17

Savannah is a self-employed building contractor who specialises in installing swimming pools. Year on year her residual income tax can fluctuate from $57,000 to $110,000. She notes the changes to the safe harbour rules have extended these rules to non-individuals. Savannah looks to take advantage of these rules and decides to set up a company, Savvy Pools Limited. During the year she bills clients from herself and from the company so that the income from the business is split between the company and herself.

At the end of the income year Savannah and Savvy Pools Limited file their tax returns and they have residual income tax of $59,999 and $59,999 respectively. In this case there is no commercial reason for the income from the same income earning activity to be split in this manner other than to take advantage of the safe harbour concession.

It is likely that Savannah and Savvy Pools Limited will be considered to have a provisional tax avoidance arrangement and the safe harbour will not apply to either taxpayer.

Example 18

Jessie James owns a railroad consulting business JJ Rail Limited (JJRL). JJRL uses the standard method to pay its provisional tax. It generally has residual tax of around $40,000. Part way through the 2017–18 income year JJRL realises it is having a spectacular year and is likely to have residual income tax of $100,000. JJRL decides to set up a subsidiary company, JJ Railroads Limited (JJRRL). It commences billing clients through JJRRL partway through the year. At the end of the income year JJRL, which has paid all its required provisional tax instalments on time throughout the year, calculates its residual income tax as $59,000. JJRRL calculates its residual income tax as $50,000. All the other criteria of section 120KE(1) are satisfied, and prima facie, both JJRL and JJRRL will fall within the safe harbour.

However, because the setting up of the new subsidiary and the transfer of income stream from one entity to the other is for no other apparent commercial reason it is likely that both companies have a provisional tax interest avoidance arrangement and the safe harbour will not apply.

Allowing contractors to elect their own withholding rate

An amendment has been made which will allow contractors who are subject to the schedular payment rules to elect their own withholding rate without having to apply to Inland Revenue for a special tax code.

Background

Previously, a contractor subject to the schedular payment rules was subject to a flat rate of withholding. This rate would often not accurately match the contractor's actual income tax liability. Contractors could obtain a special tax code to alter their rate, but the process could increase compliance costs for them, requiring them to apply to Inland Revenue and supply supporting information.

Key features

A new rule allows contractors who are subject to the schedular payment rules to elect their own withholding rate without having to apply to Inland Revenue for a special tax code.

There will be some situations when a contractor will not be able to elect their own rate. These include:

- when a contractor has not provided their name and IRD number using a form approved by the Commissioner, a "no-notification rate" applies of 20% for non-resident companies and 45% for other contractors; and
- when a contractor has not met a liability under an Inland Revenue Act, the Commissioner can prescribe a rate of withholding.

A minimum rate of withholding applies to contractors. For non-resident contractors and contractors with temporary work visas, this minimum rate is 15%, for all other contractors the minimum rate is 10%.

If a contractor has changed their rate twice in a 12-month period, they will require the consent of the payer to any further changes.

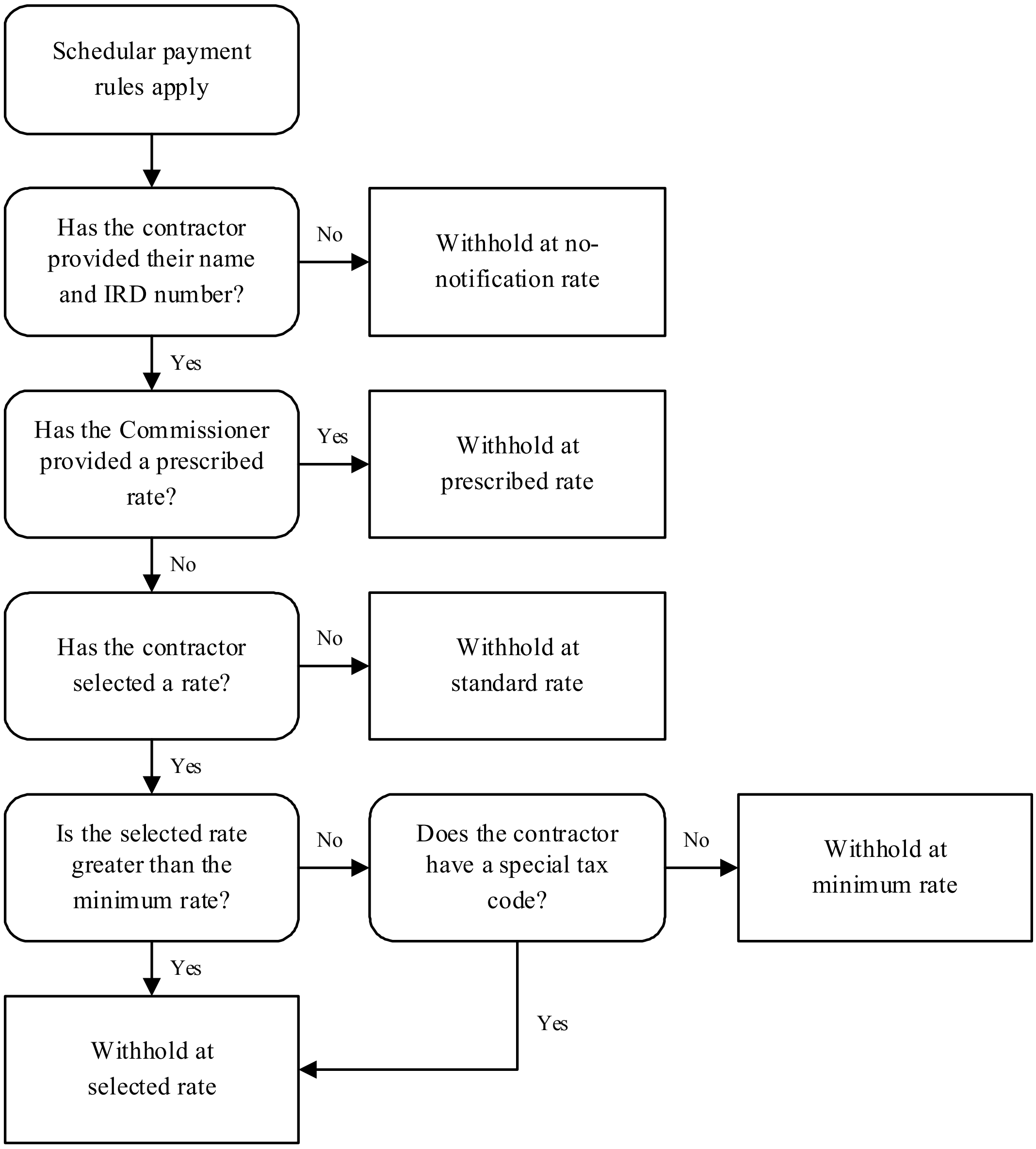
If a contractor has not selected a rate, a "standard rate" applies. This standard rate is the relevant rate listed in schedule 4 of the Income Tax Act 2007.

Application date

The amendment came into force on 1 April 2017 and applies to payments made from 1 April 2017, regardless of when the services relating to the payment were performed.

Detailed analysis

New section RD 10B of the Income Tax Act 2007 sets new rules for what rates apply for contractors subject to the schedular payment rules. The flowchart below summarises these rules:



Overview of different rate types

	Description	Rate
Elected rate	Chosen by the payee.	10% – 100% (15% – 100% for non-residents and holders of temporary visas)
Special rate	Payee can request from Commissioner.	Only necessary if the payee wants a rate lower than 10% (or 15% as above)
No notification rate	When the payee does not provide name and IRD number to the payer in the form approved by the Commissioner.	20% for non-resident companies 45% for other contractors
Prescribed rate	Set by Commissioner when the payee has not met a liability under the Inland Revenue Acts.	Cannot exceed 50%
Non-resident entertainer rate	This rate must be used by non-resident entertainers.	20%
Standard rate	The rate for the activity or arrangement set out in schedule 4, which will apply if none of the rates set out above apply.	Vary between 10.5% and 33% depending on the type of activity or arrangement

Elected rate

New section RD 10B(3)(a) of the Income Tax Act 2007 and section 24LB of the Tax Administration Act 1994 provide that contractors subject to the schedular payment rules may elect the withholding rate that is to apply to payments to them.

To elect a rate of withholding, the contractor must notify the person making the payment of the rate to apply and this notification must be made in a form approved by the Commissioner. The selected rate continues to apply until the contractor makes a new election or until the contractor is no longer able to elect a rate due to a prescribed rate notice being given or otherwise.

Minimum rate

To address the risk that contractors may attempt to defer or avoid paying their tax by choosing an artificially low withholding rate, section 24LB(2) provides that contractors must elect a rate of withholding that is not less than the minimum rate.

For non-resident contractors and contractors who are holders of temporary entry class visas, the minimum rate is 15%. For all other contractors, the minimum rate is 10%.

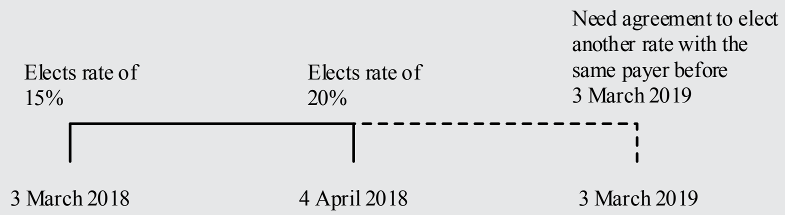
Special tax rate

A contractor may have a rate lower than the minimum if they obtain a special tax rate certificate under section 24N of the Tax Administration Act 1994.

Repeatedly changing withholding rates

If a contractor has previously elected a withholding rate twice in a 12-month period to the same payer, they require the consent of the schedular payer to make any further changes in their withholding rate.

Example 19



On 3 March 2018 Caroline starts work as a building contractor for Small Builders Ltd. Payments from Small Builders to Caroline are subject to the schedular payment rules and Caroline initially selects a withholding rate of 15%.

On 4 April 2018, Caroline wishes to change her withholding rate and notifies Small Builders that she wishes to have a withholding rate of 20% apply to her. Caroline does not require the consent of Small Builders to this change as she has only elected a withholding rate once within the last 12 months. However, if Caroline wishes to make any further changes to her withholding rate for payments made by Small Builders up till 3 March 2019, she will require the consent of Small Builders.

On 5 August 2018, Caroline starts work for Large Builders Ltd. Caroline can elect a new withholding rate without the consent of Large Builders Ltd as she has not previously elected a withholding rate with Large Builders Ltd.

No notification rate

Section RD 10B(2) provides that when a contractor does not give their name and IRD number to their payer in a form approved by the Commissioner,[27] payments to them must have tax deducted at the "no notification rate". The no notification rate is 20% for non-resident companies, and 45% for all other contractors.

This replaces the current "no notification" rate for schedular payments in section RD 18 of the Income Tax Act 2007. This is intended to provide a simpler "no notification" rate for schedular payments that is aligned with the rate that applies to employees.

Prescribed rate

Section RD 10B(4) of the Income Tax Act 2007 and section 24LC of the Tax Administration Act 1994 provide that when a contractor has not met a liability under the Inland Revenue Acts the Commissioner has the ability to prescribe a withholding rate.

The process for the prescribed rate is similar to the one for deduction notices under section 157 of the Tax Administration Act 1994, and requires a notice to be provided to the payer or the contractor that a different rate should be applied. If a notice is provided to the payer, the payee must also be provided a notice unless, after making reasonable enquiries, the Commissioner does not have a valid address for the contractor.

[27] The Commissioner has approved the *Tax rate notification for contractors (IR330C)* for the purposes of the notification requirements.

Under the amendments the Commissioner can require two different types of prescribed rate deductions. These are:

- standard schedular payment deductions under the ordinary PAYE rules (which provide PAYE tax credits for the contractor); or
- additional deductions, which are used to meet the contractor's tax debts or other liabilities.

The additional deductions would generally be required to be recorded on a separate line in the employer monthly schedule and under a different tax code. This is similar to the way additional deductions are currently done for student loans. When additional deductions are paid in this way, the initial late payment penalties charged on the original debt are not applied.

Revocation of prescribed rate

The Commissioner can rescind a prescribed rate at any time.

A taxpayer can also apply to have the prescribed rate notice rescinded by the Commissioner.

For prescribed rates relating to standard schedular payment deductions, the Commissioner must revoke the prescribed rate on application, if she is satisfied that all liabilities under the Inland Revenue Acts have been met and she is reasonably satisfied that the contractor will be likely to meet their liabilities in the future.

For additional deductions to meet the contractor's tax debts or other liabilities, the Commissioner must revoke the prescribed rate on application, if she is satisfied that the contractor has paid all tax due and payable.

The Commissioner does not intend to use this prescribed rate notice to require additional deductions to meet a contractor's other tax debts until schedular payments are administered in Inland Revenue's new computer system (START).

Example 20

Ben is a building contractor. He earns $120,000 each year from his building contracts with several major building companies. Ben elects a withholding rate of 10% and $12,000 is withheld from him for the year.

Ben predominantly provides labour services and has minimal deductions. His end-of-year tax liability is $30,000 and so Ben has a terminal tax bill of $18,000. Ben does not pay his terminal tax bill and so ends up with a tax debt.

The Commissioner prescribes a new rate of withholding to Ben and his payers. This new rate is:

- 25% under the standard schedular payment code (WT). Ben receives PAYE credits for these amounts and these amounts are intended to ensure that Ben does not have an end-of-year income tax liability and further tax bills; and
- an additional 15% under a new tax code and recorded on a new line in the employer monthly schedule. Amounts withheld under this code are used to pay Ben's tax debt for the previous year.

Standard rates

If a contractor does not elect a rate of withholding under section 24LB of the Tax Administration Act 1994, section RD 10B(3)(b) of the Income Tax Act 2007 provides that the standard rate of withholding applies to them.

The standard rate is the relevant rate set out in schedule 4 of the Income Tax Act 2007. For contractors working for labour-hire firms and those under voluntary withholding agreements the standard rate is 20%.

For other contractors the standard rate in schedule 4 is the same as the rate that currently applies to those payments. This means that if a contractor that was previously subject to the schedular payment rules does not elect a different withholding rate when the amendments come into force, their withholding rate remains unchanged.

Non-resident entertainers

The amendments do not apply to non-resident entertainers. Non-resident entertainers will continue to have a flat withholding rate of 20%. These entertainers can continue to have withholding treated as a final tax and will not have to file returns.

Extending withholding to labour-hire firm contractors

Amendments have been made which extend the schedular payment rules to contractors that work for labour-hire firms.

Background

Over the last two decades there has been large growth in the labour-hire firm industry. The new rules better reflect changes within the industry and update the rules more generally for contractors working for this industry.

Labour-hire firms provide workers to perform services to clients, either as employees or contractors. The previous withholding rules did not generally apply to contractors engaged by labour-hire firms. This meant these contractors were required to manage their own tax obligations, including provisional tax. It also meant that contractors had opportunities for non-compliance (whether deliberate or accidental).

In addition, using a company structure has become increasingly popular with contractors. Payments to companies are generally not subject to withholding tax under the schedular payment rules.

Key features

The amendments add payments by labour-hire firms to their contractors to the list of payments that are subject to the schedular payment rules.

As a result, labour-hire firms will be required to withhold from all payments made to their contractors that work as part of their labour-hire business. They will be required to withhold at the relevant rate as described under the amendments outlined in "Allowing contractors to elect their own withholding rate".

Labour-hire firms will also have an obligation to deduct withholding tax when they make payments to companies used by contractors. Labour-hire firm contractors who are resident in New Zealand will not be eligible to receive certificates of exemption from withholding.

A labour-hire firm is defined as "a person which has as one of its main activities the business of arranging for a person to perform work or services directly for clients of the entity".

Application dates

The amendments came into force on 1 April 2017.

If a labour-hire firm is unable to have systems in place for reasonably cost-effective compliance with the new rules before 1 April 2017, the amendments apply to the earliest of:

- 1 July 2017; or
- the date on which the labour-hire firm has systems in place for reasonably cost-effective compliance with the labour-hire firm rules.

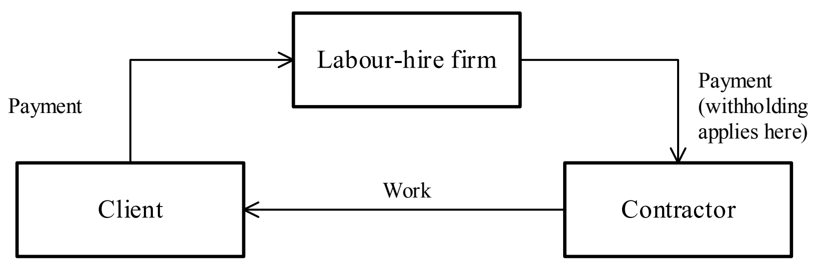
Detailed analysis

The amendments insert Part J to schedule 4 of the Income Tax Act 2007, which adds payments made by labour-hire firms to contractors under a "labour-hire arrangement" to the schedular payment rules.

Under Part J, payments are covered by the schedular payment rules when:

1. The payment is made under a labour-hire arrangement (as defined).
2. One of the main activities of the person making the payment is providing labour-hire arrangements (that is, the labour-hire arrangement is not incidental to the main business of the person).

1. The payment is made under a labour-hire arrangement



A labour-hire arrangement is an arrangement which in whole or part involves the performance of work or services by a person (the payer) directly for the client of the payer, or directly for a client of another person. The payer receives payment from the client and pays the worker.

Arranging for a person to perform work or services directly for clients means that there is an agreement to provide a worker to the client, who will then provide their services at the general direction of the client. This does not include a contract in which the parties agree to deliver a given result or outcome. For example, if a contract provided for Firm A to make available some painters to a building company to work for them for a period of time, and the painters work at the general instruction of the building company, then Firm A would be arranging for a person to perform work or services.

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In contrast, if a contract provided for a painting company to paint houses for a building company, and the painting company contracted some labourers to work for it in completing the service, the contract between the painting company and building company would be a contract to produce a given result (the painted houses) rather than a contract arranging for a person to "perform work or services directly for clients".

Directly for a client of another person

A labour-hire arrangement also includes situations when there are chains of labour-hire firms involved or when a labour-hire firm provides a worker to a sub-client of the labour-hire firm. This can happen if a labour-hire firm arranges for another labour-hire firm to provide workers for their client.

2. *One of the main activities of the payer is providing labour-hire arrangements (that is, the labour-hire arrangement is not incidental to the main business of the entity)*

The amendment only applies when one of the main activities of the entity making the payment is providing labour-hire services. This means that withholding under the amendment only applies if the entity is carrying on a labour-hire business. It is not necessary for the labour-hire activities to be the sole business, or even the main business of the payer. However, a merely incidental business is not sufficient to require withholding.

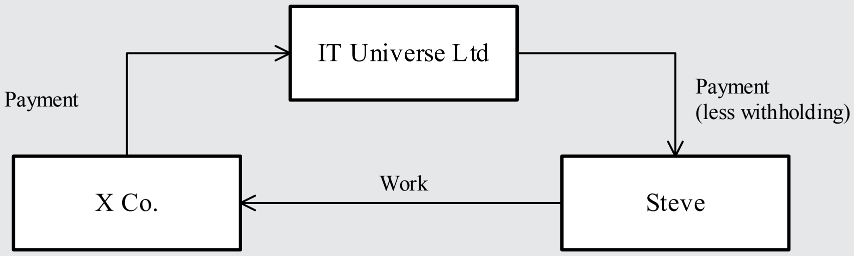
For something to be one of the main activities of the business requires the activity to be more than incidental to the other activities of the firm. For example, a wedding planner may arrange for persons to perform makeup, or other services directly for clients, but because this is incidental to the main activity of the planner, it will not make the wedding planner a labour-hire firm.

A business can have more than one main activity. For example, a labour-hire firm may have main activities of providing workers directly, as well as providing direct contracting work. The key question to ask is whether arranging to provide workers directly is being done in a business of its own right, or whether it is merely a requirement or incidental activity of another activity of the business.

The amendment is similar to Australia's Pay-As-You-Go withholding rules.

Example 21

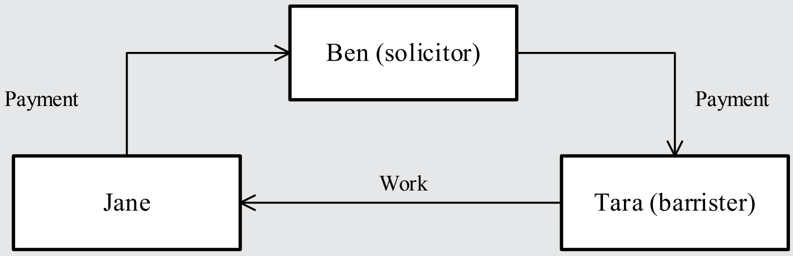
IT Universe Ltd provides contractors to other businesses to help with their IT projects. X Co. asks IT Universe Ltd for IT contractors to help with an upgrade of its systems. IT Universe Ltd provides one of their contractors (Steve, a New Zealand resident) to assist X Co. Steve works at the general direction of IT Universe Ltd.



IT Universe Ltd is arranging for a worker (Steve) to provide work directly for their client (X Co.). As a result, they are in a labour-hire arrangement with Steve and X Co. and this arrangement is part of their labour-hire business. IT Universe Ltd is required to withhold tax from any payments to Steve. The rate will be the applicable rate as set out in the earlier section "Allowing contractors to elect their own withholding rate". If he does not specify a rate then the standard rate for labour-hire firm contractors of 20% will apply.

Example 22

Ben is Jane's solicitor. Jane is engaged in litigation and requires a barrister to represent her in court. For this purpose, Ben instructs Tara and pays Tara on Jane's behalf.

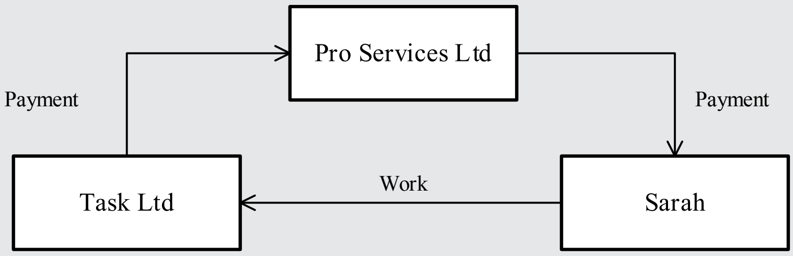


Ben is arranging for a contractor (Tara) to provide work directly for their client (Jane). However, Ben is not required to withhold from these payments because arranging for people to work for his clients is not one of his main activities. The payment is incidental to his business of providing legal services.

Example 23

Pro Services Ltd is a professional services firm whose core business is providing consulting and advisory services to clients. Pro Services Ltd engages many of its staff as contractors.

Sarah is one of these contractors whose work has impressed Task Ltd who is one of the clients of Pro Services Ltd. Task Ltd asks Pro Services Ltd for Sarah to work for them for six months to assist with one of their projects. Under this arrangement, Sarah will work at the general direction of Task Ltd.



Pro Services Ltd is arranging for a contractor (Sarah) to perform services directly for the client of Pro Services Ltd (Task Ltd). As a result, this is a labour-hire arrangement.

However, entering into labour-hire arrangements is not one of the main activities of Pro Services Ltd. Instead this is a one-off transaction that is being done incidental to Pro Services Ltd's core business. Pro Services Ltd did not advertise to provide this service and does not expect to enter into similar arrangements in the future or plan to do so as a business in its own right.

Example 24

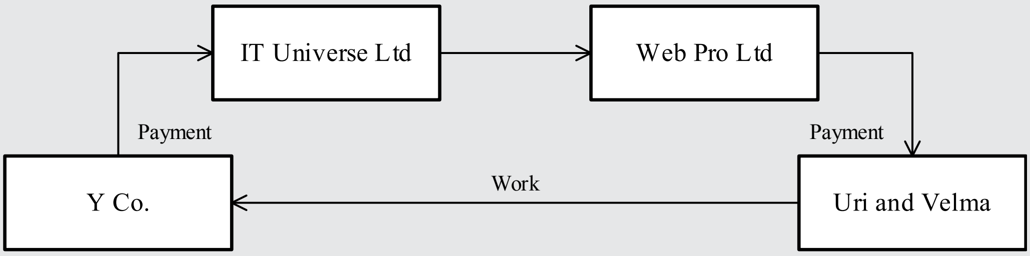
Pro Services Ltd found the previous arrangement with Task Ltd to be a success, and starts offering similar services to more clients and advertising this service on its website.

Pro Services Ltd is now providing labour-hire arrangements as a business in its own right. As a result, it can be considered to be one of the main activities of Pro Services Ltd, and payments made to Sarah and other contractors as part of this labour-hire business are subject to the schedular payment rules.

Example 25

Y Co. asks IT Universe Ltd for web designers to help them build a new website. IT Universe agrees to provide a number of web designers to Y Co. but is unable to find enough suitable people.

IT Universe Ltd goes to Web Pro Ltd (another labour-hire firm) and arranges for some of Web Pro's contractors (Uri and Velma) to perform work for Y Co.



Web Pro Ltd is arranging for contractors (Uri and Velma) to perform work directly for the client (Y Co.) of another entity (IT Universe Ltd). As a result, they are in a labour-hire arrangement and this arrangement is part of their labour-hire business. Web Pro Ltd is therefore required to withhold from any payments it makes to Uri or Velma.

Example 26

Paul is a builder and contracts to build a house for Susan. He subcontracts another contractor, Bruce, to do the plumbing work for the house. Paul is not required to withhold from payments to Bruce because he is not arranging for workers to perform work directly for clients. Instead Paul is arranging to produce a specified output for Susan (building a house).

Company exception

The amendments provide that the general exception to the schedular payment rules for companies will not apply to payments under labour-hire arrangements.

That means labour-hire firms will be required to withhold from payments in the circumstances outlined above regardless of the type of legal entity the payments are made to. This applies regardless of whether the payment is also covered by the schedular payment rules due to it being a payment of a type described in another part of schedule 4 of the Income Tax Act 2007.

A company that finds it is being over-withheld as a result of this, can apply for a special tax code to reduce its withholding rate below the minimum rate. This can include applying for a withholding rate of 0%.

Example 27

As in the earlier example, IT Universe Ltd. has agreed to provide web designers for Y Co. IT Universe arranges for Web Pro Ltd to provide workers for Y Co.

IT Universe is arranging workers to provide work directly to clients. As a result, they are in a labour-hire arrangement and this labour-hire arrangement is part of their labour-hire business. As a result IT Universe Ltd is required to withhold from any payment made to Web Pro.

Web Pro may apply for a special tax code to reduce its rate of withholding (including applying for a rate of 0%).

Associated party transactions

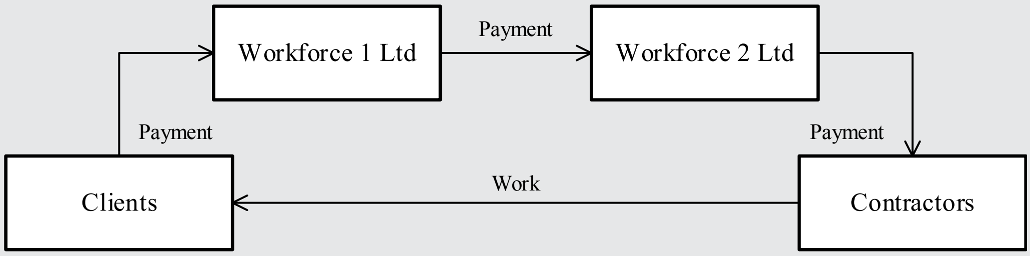
If the payer and payee are associated persons under sections YB 2 (Two companies) or YB 3 (A company and a person other than a company), the payer may choose not to treat the payment as being subject to withholding under the labour-hire firm rules.

This choice is intended to prevent overreach in the rules where the rules could apply to payments that are effectively made between entities that are part of the same business. In these situations, it is considered that the requirement to withhold would impose additional compliance costs for little benefit.

Example 28

Workforce 1 Ltd is a labour-hire firm that provides workers to perform work directly for clients. As part of its business structure Workforce 1 Ltd chooses to have its sales, marketing and client-facing side of the business managed by Workforce 1 Ltd while its staff management is handled by Workforce 2 Ltd. Workforce 1 Ltd and Workforce 2 Ltd are part of a wholly owned group.

Workforce 1 Ltd. pays Workforce 2 Ltd part of the fees received by clients in order to pay their contractors.



Workforce 1 Ltd and Workforce 2 Ltd are wholly owned companies and as a result are associated under section YB 2. As a result, Workforce 1 Ltd may choose to treat payments made to Workforce 2 Ltd as not subject to withholding under the labour-hire firm rules.

Workforce 2 Ltd will still need to withhold from payments it makes to its contractors.

Certificates of exemption

Under the amendments, contractors that are resident in New Zealand and are working for labour-hire firms cannot obtain certificates of exemption to exempt themselves from the schedular payment rules. These contractors cannot obtain certificates of exemption even if the payment is covered by the schedular payment rules by virtue of another part of schedule 4 of the Income Tax Act 2007.

These contractors may still apply for a special tax rate if withholding is inappropriate, which includes being able to apply for a 0% rate. This means that all resident contractors working for labour-hire firms must have payments to them recorded on the Employer Monthly Schedule even if a 0% rate of withholding applies to them.

Non-resident contractors who work for labour-hire firms may continue to use certificates of exemption.

Example 29

Agriculture Angels is a labour-hire firm that provides fruit pickers to farmers. The fruit pickers are engaged as contractors by Agriculture Angels and payments to them are covered by the schedular payment rules under the new labour-hire firm rules (Part J of schedule 4) as well as those for worker services relating to primary production (Part C of schedule 4).

The contractors of Agriculture Angels cannot utilise certificates of exemption from withholding. Instead, these contractors will need to apply for special tax rates of 0% if withholding is not appropriate for them.

Transitional rule

To allow an easier transition to special tax rates for contractors working for labour-hire firms, a transitional rule applies for these contractors whose certificates of exemption are no longer valid as a result of the amendments. Under the transitional rule, contractors who have a certificate of exemption before 1 April 2017 may have the certificate treated as a special tax rate of 0% till 1 April 2018, if the certificate of exemption is invalid as a result of the amendments.

Voluntary withholding agreements

Amendments have been made which will allow contractors not covered by the schedular payment rules to opt in to the rules with the consent of their payer.

Background

Currently contractors not covered by the schedular payment rules are not able to have tax withheld on a payday basis. Many of these contractors may prefer to pay their tax through the schedular payment rules.

Key features

Contractors that are not subject to the schedular payment rules will be able to enter into a voluntary withholding agreement with their payers. If an agreement is entered into, the contractor becomes subject to the schedular payment rules and the payer will be required to withhold from payments made to them.

The proposed amendments insert Part W into schedule 4 of the Income Tax Act 2007.

Part W sets out that a payment to a person is a schedular payment when:

- there is no obligation to withhold from the payment under the Income Tax Act 2007 or the Tax Administration Act 1994; and
- the contractor and their payer have agreed to treat the payment as a voluntary schedular payment, and have recorded their agreement in a document.

If these two criteria apply, the schedular payment rules apply and the payer is required to withhold from the contractor at the rate selected by the contractor (as per the amendments outlined in "Allowing contractors to elect their own withholding rate").

This can apply to payments made to companies as well as payments such as expense reimbursements,[28] which previously have not attracted withholding tax so long as the parties have entered into an agreement for withholding to apply.

Determining whether there is a valid agreement is based on standard contract law principles and requires there to be offer and acceptance, intention to create legal relations and objective evidence of agreement (which will usually be satisfied if the requirement that the agreement must be in a document has been met).

A document can be a memorandum, email, letter, or formal contract between the parties. As long as there is sufficient written evidence that there has been a required agreement between the parties (which can be either electronic or in hardcopy), this requirement will be met.

Payments covered by voluntary withholding agreements are excluded from the definition of "employer and employee" for the purpose of the FBT rules. This means that fringe benefit tax does not apply when fringe benefits are provided to contractors under voluntary withholding agreements.

Application date

The amendments came into force on 1 April 2017.

Use-of-money interest and transfers of tax

Amendments have been made to sections 120C, 173L, 173M and 173S of the Tax Administration Act 1994 to prevent taxpayers from transferring tax to an earlier period that exceeds the amount in debt or in dispute in that period, and to clarify when UOMI starts and when a transfer takes effect for GST refunds and GST overpayments.

Background

Taxpayers are able to transfer tax credits to other tax periods, tax types or taxpayers.

Currently, taxpayers are able to transfer amounts that exceed the amounts owing in previous periods. When this happens they are paid UOMI from an earlier date than if they had not moved the money.

The Tax Administration Act 1994 does not distinguish between a GST refund, which occurs when GST inputs/expenses exceed GST outputs/sales, and a GST overpayment, which occurs when a taxpayer overpays their GST liability. As both actions result in a credit, it can be argued that a GST overpayment constitutes a refund, and is therefore eligible for the transfer date applicable to GST refunds, which is earlier than the transfer date applicable to overpayments. The date of transfer affects when UOMI on a previous overpayment stops being charged. Therefore a taxpayer transferring an overpayment of GST to settle a debt in a previous period will pay less UOMI to Inland Revenue than was intended because the payment will be transferred at the earlier refund date, rather than the date at which they made the overpayment.

Key features

Sections 173L, 173M and 173S of the Tax Administration Act 1994 have been amended to limit transfers of tax within a taxpayer's accounts, transfers of tax to another taxpayer and transfers of interest on overpaid tax to the total of (for the requested transfer period at the chosen transfer date):

- the debt owing by the relevant taxpayer;
- the taxpayer's deferrable tax;

[28] With the exception of amounts to which the Commissioner has made a determination under section RD 8(3).

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- the amount under a notice of proposed adjustment; and
- any amount agreed with the Commissioner.

Section 173L has also been amended to clarify when a transfer will take effect for GST refunds and GST overpayments.

Section 120C has been amended to clarify the date that UOMI will start for GST refunds and GST overpayments.

Application date

The amendments came into force on 5 February 2017.

Amending the rules for new and increased assessments by the Commissioner

Section 142A of the Tax Administration Act 1994 has been amended to enable the Commissioner to offset any credits or refunds the taxpayer has against the taxpayer's tax liability arising from a new or increased assessment by the Commissioner.

Sections 139B, 139BA and 142B have been amended to ensure late payment penalties and shortfall penalties continue to be correctly applied following the amendment to section 142A.

Background

Generally, when the Commissioner makes a new assessment, or increases an assessment, a new due date is set for the payment of the resulting tax. This allows the taxpayer time for payment before late payment penalties, which accrue from the day after the new due date, are imposed. Use-of-money interest continues to apply from the day after the original due date for payment of the tax.

When a new due date is set, any credits or refunds available before the new due date are generally refunded to the taxpayer as they cannot be offset against the upcoming liability as it is not yet "due". The taxpayer then needs to make a payment to Inland Revenue by the new due date, shortly after receiving the refund.

Inland Revenue's FIRST computer system was unable to give additional time before the imposition of late payment penalties without setting a new due date. Its new system, START, is able to use the original due date for payment but still allow time for payment before the imposition of late payment penalties.

Key features

Section 142A of the Tax Administration Act 1994 has been amended so that a new due date for payment is not set following a new or increased assessment by the Commissioner. This ensures that any credits or refunds the taxpayer may have can be offset against the taxpayer's liability arising from the new or increased assessment.

Sections 139B and 139BA have been amended to ensure taxpayers are given the same amount of time as they previously were given for payment of the tax before the imposition of late payment penalties. Section 142B has also been amended to ensure taxpayers have the same amount of time for payment of any shortfall penalties.

Application date

The amendments came into force on 5 February 2017.

Prescribed forms

An amendment to section 35 of the Tax Administration Act 1994 has been made to confirm that information required under a prescribed form can be provided verbally (including by telephone or in person) when the Commissioner of Inland Revenue considers that to be appropriate.

Background

Section 35 allows the Commissioner to prescribe forms and electronic formats that have not otherwise been prescribed. This could be interpreted as requiring the information required under the prescribed form to be provided electronically or in writing, excluding providing the information verbally.

With some prescribed forms it is easier for taxpayers and more efficient for Inland Revenue if the information (or some of the information) required in the form can be provided verbally. For example, more than 50 percent of the paper GST registration forms submitted are incorrectly completed. If the taxpayer was not able to verbally correct their registration form, they would have to complete the registration form again and send it in a second time. This change confirms that an Inland Revenue staff member can telephone the taxpayer and correct the errors on the basis of their discussion with them.

Key features

Section 35 has been amended to give the Commissioner a discretion to allow a person to provide the information in a prescribed form in a manner other than writing if the Commissioner is satisfied that, in the circumstances, it is appropriate.

This discretion will not be exercised in all circumstances – for example, it is not intended that information under a notice of proposed adjustment could be provided verbally.

Application date

The amendments came into force on 5 February 2017.

Administration of the late payment penalty rules

An amendment has been made to section 139B of the Tax Administration Act to enable Inland Revenue to continue to administer the late payment penalty grace period during the period in which tax types are operated out of two Inland Revenue software systems – FIRST (the older system) and START (the new system). An amendment to section 138E has been made to ensure certain rights of challenge do not apply to section 139B.

Background

A late payment penalty is imposed if a taxpayer does not pay on time. If a taxpayer has paid on time all relevant taxes due in the two years before the default in question, the Commissioner must issue a notice to the taxpayer specifying a further date for payment of the unpaid tax (a "grace period"), before late payment penalties can be imposed.

Tax types will transition from Inland Revenue's older FIRST system to the START system in stages. This raises an issue in relation to the grace period, as information relating to the taxpayer's compliance history will reside in two systems.

Key features

Section 139B has been amended to introduce a discretion into the provisions setting out whether a taxpayer is entitled to a grace period from late payment penalties. The discretion will enable the Commissioner to ignore defaults in payment if:

- doing so is necessary due to tax types being administered from different systems as a result of the coexistence of FIRST and START; and
- doing so would not result in the imposition of a penalty that is greater than would otherwise have been imposed (had she not ignored these defaults in payment).

In practice, this discretion will be applied to allow the Commissioner to look only at the tax information about a taxpayer's compliance history held in the system from which the tax type in default is being administered. For example, if the taxpayer defaults on a GST payment and GST is being administered in START, the Commissioner would only look at the taxpayer's compliance history in START to determine the taxpayer's eligibility for a grace period.

A "compliance history indicator" providing a snapshot of the taxpayer's compliance history for all relevant tax types for the last two years will be brought across as tax types transition to START. This will enable START to consider the taxpayer's compliance history for tax types not administered in START to some extent, but it will become less relevant over time given a grace period is based on the taxpayer's compliance history two years prior to default. Once all tax types have transitioned to START the Commissioner will once again only need to look at one system (START instead of FIRST) to determine the taxpayer's compliance history for all relevant tax types. The compliance history indicator will no longer be necessary.

Section 138E has also been amended to ensure that certain rights of challenge do not apply to section 139B.

Application date

The amendments came into force on 5 February 2017.

Cancellation of interest

Amendments have been made to modify the cancellation of interest rules, in certain circumstances, to help Inland Revenue to simplify the process of issuing cancelled interest statements to taxpayers who mistakenly overpay.

Background

Section 183C of the Tax Administration Act 1994 contains rules around the cancellation of interest where multiple statements are issued by Inland Revenue. Specifically, subsection 183C(4) provides that when the Commissioner issues a statement of account to a taxpayer after the original due date for payment to which the statement of account relates, and the taxpayer pays the tax and any interest payable for the period before the date of the statement within 30 days of the statement being issued, any interest charged between the date of the statement and the date of payment will be cancelled.

This creates some confusion for taxpayers in that if another statement is issued subsequently, that statement will have the interest accrued to the date of the second statement. Taxpayers will often pay what is shown on the statement notwithstanding the portion of interest charged between the dates of the two statements is ultimately cancelled. This leaves small credit balances in accounts.

Behind the scenes the FIRST computer system has a complex set of programming and rules to track these individual statements and calculate the amount of interest that is ultimately cancelled. In an effort to simplify the process around the cancellation of this interest in the future, Inland Revenue is investigating better ways to deal with these statement issues which retain the general rule yet simplify the process of providing taxpayers with "what you see is what you pay" statements to avoid the current overpayment issues.

Because the introduction of START is being undertaken in phases it is necessary to provide a temporary solution until all taxes are migrated to START and the statement process can be standardised across all tax types. Goods and Services Tax (GST) is the first tax to be migrated to START and this change will only affect statements issued and interest charged in relation to GST.

Key features

New subsection (4C) has been introduced to section 183C of the Tax Administration Act 1994. This provides for a modified cancellation of interest rule where:

(a) the Commissioner issues another statement of account (the second statement) to a taxpayer within 30 days of the issue of a statement of account to a taxpayer after the original due date for payment of tax to which the statement relates (the first statement);

(b) the first and second statements are for GST and penalties related to the GST;

(c) the liability for the underlying GST is the same in the first and second statement; and

(d) the GST and related penalties in the second statement, together with any interest payable in relation to the period before the date the first statement is paid to the Commissioner within 30 days after the date on which the second statement is issued, or the due date of tax, whichever comes first.

The Commissioner will cancel the taxpayer's liability to pay interest in relation to the GST and penalties charged between the dates of issue of the first statement and the date payment is made.

This essentially mirrors the current rule, with the exception that if the underlying liability to GST increases between the two statements, the 30-day period will reset.

Application date

The new cancelation of interest rule came into force on 5 February 2017.

Detailed analysis

The current cancellation of interest rules seek to allow taxpayers time to make payment on a statement before accruing additional interest in respect of a tax debt where the statement is issued after the due date for payment.

The rules around the cancellation of interest are reasonably complex in that they require various statements to be tracked and a calculation of the interest to be cancelled undertaken with reference to various statements.

These rules can also be confusing to taxpayers and it may mean that what the statement says they owe is not actually the amount they need to pay so long as they make payment within the 30-day limit. This can result in small overpayments where a taxpayer pays the amount on a statement only to have a portion of the interest to date on the statement cancelled.

Example 30

CK Enterprises Ltd (CK) is a company specialising in photography for social media sites. The owner of CK, Ang, receives the following statements for CK:

Day 1 - Statement issued showing amount payable of $250 (tax only)

Day 5 - Statement issued showing amount payable of $251 (tax plus $1 interest)[29]

Day 10 - Statement issued showing amount payable of $252 (tax plus $2 interest)

Day 15 - Statement issued showing amount payable of $253 (tax plus $3 interest)

Day 20 - Payment received for $253

Under the previous rules because the payment was received within 30 days of the date of the first statement, any additional interest charged between the date of the first statement and the payment date will be cancelled.

This means the payment of $253 will bring the account into a credit situation of $3, based on the statement issued on Day 1. The increased amount due to UOMI showing as payable on the statements issued on days 5, 10 and 15 would be cancelled.

This will mean that Ang will have to contact Inland Revenue to deal with the small balance and have this transferred or refunded incurring compliance costs.

The way Inland Revenue's older FIRST system deals with the cancellation of interest uses complex programming and tables to track the individual statements to calculate the amount of interest to cancel. Inland Revenue is investigating ways to simplify the statement process within its new START system. This can only be fully achieved once all taxes are migrated to START.

Because START is being implemented in a phased approach it is necessary to put in a temporary solution for taxes which are migrated to START until a more complete solution can be implemented when all taxes are migrated.

This modification to the cancellation of interest rule will only apply to GST, which was migrated to START on 5 February 2017. The modified rule essentially mirrors the previous rule, with the exception that when the underlying tax liability of the taxpayer increases, the 30-day interest period will reset.

This will simplify the cancellation of interest rules for taxpayers so that taxpayers will see statements that show them the actual amount to pay and the system will not have to track multiple statements through a complex mechanism.

Example 31

Archer Ltd provides professional coaching services to rugby clubs. On 1 August 2017 its owner, Garry, receives a statement from Inland Revenue after the original due date which says that Archer Limited has a June GST liability of $250 plus a $12.50 initial late payment penalty and $3 UOMI. The statement also indicates that interest will continue to accrue at 50 cents per day until the amount is paid unless the total is paid by 31 August 2017.

Subsequent to the issue of that statement Archer Ltd receives another statement of account for that same period on 15 August 2017 showing the same amounts, which it pays in full on 20 August. The accrued interest between the 1 August statement and the payment on 20 August is cancelled and Archer's June GST period has a nil balance.

Example 32

Assume the same facts as in Example 31 but the second statement issued to Archer Ltd reassesses the liability for the June GST period from $250 to $260. That statement now shows the amount of the GST liability of $260, an initial late payment penalty of $13, and updated UOMI of $5, including interest from 1 August to the date of the second statement, 15 August. If Archer pays the total amount of $278 within 30 days of the date of this statement, any interest incurred by Archer from 15 August to the date payment is made will be cancelled.

[29] The interest amounts used are for illustrative purposes only.

NEW LEGISLATION

Accounting Income Method (AIM)

The Accounting Income Method (AIM) for the payment of provisional tax was introduced in Part 2 of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act. This method enables taxpayers to make provisional tax payments through approved accounting software with no risk of use-of-money interest, beginning on 1 April 2018. The requirements and detail of this method will be contained in a Determination released by Inland Revenue later this year. Detailed information about the full use of AIM by taxpayers and software providers will be contained in a future edition of the *Tax Information Bulletin* following the release of the Determination.

DISCLOSING REPORTABLE UNPAID TAX TO CREDIT REPORTING AGENCIES

Sections 3, 81(4)(sc) and 85N of the Tax Administration Act 1994

An amendment to the tax secrecy rules allows the Commissioner of Inland Revenue to disclose a taxpayer's information and their significant tax debt to approved credit reporting agencies. The Commissioner will ensure the taxpayer's circumstances meet the prescribed criteria before initially disclosing the information. Once the information has been initially disclosed, the Commissioner may continue to do so until the tax debt has been resolved.

While the amendment includes all taxpayers, its practical effect is limited to non-individuals (initially, non-natural persons such as registered New Zealand companies). This is because personal information about individuals is regulated by the *Credit Reporting Privacy Code of Practice* (enabled by the Privacy Act). This code currently prevents credit reporters from receiving tax information about individuals (natural persons).

Background

Information about a taxpayer's tax debt is subject to section 81 of the Tax Administration Act 1994 that requires Inland Revenue officers to keep secret all matters relating to the Inland Revenue Acts. The amendment inserts an exception to these secrecy rules, for the purposes of disclosing taxpayer-specific information to approved credit reporting agencies.

The main effect of disclosing this information is that other businesses that trade and lend with that indebted business will become aware that they actually owe a significant amount of tax debt. Consequently, these businesses would receive a more comprehensive view of the indebted taxpayer's financial position, which will assist them when making important commercial decisions. For creditors of a tax-indebted business, unpaid tax debt can represent a similar risk as if the debt was owed to another trade creditor.

However, it is acknowledged that potentially affected taxpayers will likely be motivated to promptly resolve their tax debt, as some indebted taxpayers may be reluctant to have their tax debt information disclosed to their creditors.

Providing this information to approved credit reporting agencies will allow the information to be available to potentially affected businesses, requested when they are conducting their creditworthiness checks. This transparency will help mitigate some of the risk businesses encounter when entering into commercial arrangements.

The amendment represents a trade-off between taxpayer secrecy and reducing the opportunity for compliant businesses to be unexpectedly trading with significantly tax-indebted taxpayers. When the debt is in the process of being reasonably resolved or is a proportionally small amount, the risk to other businesses is also proportionally smaller, so disclosing taxpayer tax debt information at this point would not be considered to outweigh the importance of keeping taxpayer information confidential.

Key features

The amendment to section 81 of the Tax Administration Act 1994 introduces an exemption to tax secrecy for the purpose of communicating taxpayer information to approved credit reporting agencies. New section 85N is inserted into the Tax Administration Act 1994 to facilitate the exchange of certain taxpayer information between the Commissioner and approved credit reporting agencies.

For the purposes of this section, the taxpayer must owe a minimum amount of reportable unpaid tax. This is defined as an unpaid amount that is a liability or excess refund of:

- income tax (excluding Working for Families tax credit overpayments);
- goods and services tax; and
- amounts required to be deducted under the PAYE rules (including student loan and child support deductions, KiwiSaver employee deductions, employer superannuation contribution tax and retirement scheme contribution tax.

These amounts include any civil penalties and use-of-money interest imposed. This definition excludes amounts that are under dispute or challenge under the Tax Administration Act 1994.

Before the Commissioner can consider initially disclosing the taxpayer's information to an approved credit reporting agency, a set of requirements must be met. The criteria include:

- The reportable unpaid tax is not being considered for relief or remission, or currently included in a formal instalment arrangement.
- The taxpayer has been formally notified and at least 30 days have passed since that notification.
- The Commissioner has previously made reasonable efforts to collect the reportable unpaid tax.
- The taxpayer owes at least a minimum amount of reportable unpaid tax.

Formal notification

For the purposes of section 85N, formal notification will involve the Commissioner serving a formal notice on the taxpayer, setting out the 30-day notice period, the tax periods owing, and how the taxpayer can avoid being credit reported (by seeking relief or remission of the debt). The formal notice will also advise the taxpayer of an Inland Revenue webpage, dedicated to credit reporting. This webpage will provide information about the Commissioner's authority to disclose tax debt to approved credit reporting agencies.

If the reportable unpaid tax debt includes Commissioner-issued assessments, where the return is yet to be filed (default assessment), then these affected tax periods will be identified in the notice. The notice will advise the taxpayer to file these returns.

It is intended that the formal notice will be issued when the Commissioner is confident that the taxpayer's circumstances meet the criteria and either one of the minimum amount thresholds, and would likely continue to meet these at the end of the 30-day period, prior to being reported. At the 30-day period, before the taxpayer's information is initially disclosed, the Commissioner will ensure that the taxpayer's circumstances still meet the definition of "reportable unpaid tax".

If the taxpayer is a company, the Commissioner would serve the notice on all directors listed with the Registrar of Companies at the time the formal notices are being issued. If there is a time lag in serving all the directors, the 30-day notice period will apply from the last director served. This will ensure that all directors are aware of the action, and all directors have sufficient time to resolve the debt before the Commissioner discloses the debt to the approved credit reporting agencies. This also provides an opportunity for the director to review the debt information and discuss any data inaccuracies with Inland Revenue. In addition, the formal notice will be posted to the company's registered office.

After the 30-day period, the taxpayer must also owe the minimum amount of reportable unpaid tax. This threshold is defined as either:

- an amount that is older than a year and the amount is more than 30 percent of the taxpayer's assessable income for the last 12 months; or
- an amount prescribed by an Order in Council.

When an amount has been set or varied by an Order in Council, it will be published in the *Gazette* and on Inland Revenue's website. Using an Order in Council provides a level of flexibility to ensure this element of the threshold can be readily amended, if required.

If the taxpayer receives three notices within 12 months

The Commissioner may disclose despite the taxpayer's debt not meeting the reportable unpaid tax thresholds. This would occur when the taxpayer has received three formal notices within a year and the first two notices were ineffective because, subsequent to receiving the notice, the taxpayer has made sufficient payments to the reportable unpaid tax to remove themselves from the reportable unpaid tax threshold. This has resulted in the taxpayer's information not being disclosed.

After the third notice's 30-day period, the Commissioner may disclose, despite the taxpayer's reportable unpaid tax being below the prescribed thresholds. This is intended to address the potential concern that a taxpayer may attempt to avoid their reportable unpaid tax being disclosed, despite over time the amount of reportable unpaid tax repeatedly exceeding the minimum thresholds.

Information disclosed to approved credit reporting agencies

Once the taxpayer has exceeded the above criteria, the Commissioner can disclose taxpayer-specific information for the purposes of including the information on a taxpayer's credit report, and continue to disclose for evidencing and maintaining the accuracy of the information contained on the credit report.

The Commissioner will disclose the taxpayer's identity information in order to match the information with the approved credit reporting agency's data. If the taxpayer is a company, the Commissioner will disclose the company's name, address (number and street name) and postcode, as well as the company's NZ Business Number and the Companies Office "company number". Providing this information will ensure that the approved credit reporting agency's standard processes and checks correctly match the taxpayer to the correct credit report. If there is a mismatch, the approved credit reporting agency will send a mismatch response to Inland Revenue. This identification information will be used by the approved credit reporting agency for matching purposes only.

The Commissioner will disclose the following tax debt information:

- tax type – GST, income tax and employer deductions required to be made under the PAYE rules;
- total dollar amount of debt, per tax type; and
- the oldest debt period, per tax type.

This information will be exchanged until the tax debt is resolved in full.

The PAYE information will be expressed as a single amount under PAYE, rather than broken down into each outstanding deduction– that is, KiwiSaver deductions, child support deductions and so on. This will ensure an employee's privacy is maintained, especially when the indebted business has only a few employees.

The total debt amount will be disclosed, based on the information held by Inland Revenue's system at the time the debt information has been extracted. While the legislation is silent on the frequency of the data exchange, in practice the transfer will occur weekly.[30]

After the initial disclosure, to maintain the accuracy of the debt information on the credit report, the Commissioner will continue to routinely disclose any amount that meets the definition of "reportable unpaid tax", including where that amount falls below the significant reportable unpaid tax threshold. This includes where the taxpayer has submitted an application for write-off of tax debt or remission of penalties and/or interest, or has entered into an instalment arrangement. This is to address the issue that if the Commissioner was to abruptly stop disclosing this information, the last transaction held by the approved credit reporting agencies would quickly become inaccurate. If the taxpayer has entered into an instalment arrangement, the Commissioner will also disclose the existence of this arrangement to the approved credit reporting agency.

If the taxpayer's information has been disclosed and they consequently pay their tax debt in full, the Commissioner has the ability to separately update all approved credit reporting agencies, outside the scheduled updates. This is to resolve the issue where a taxpayer may want this change reflected on their credit report, but there is a reasonable delay before the next scheduled information update.

The taxpayer will be referred to Inland Revenue if they have a complaint about the accuracy of the tax debt information held by the approved credit reporting agencies. Inland Revenue's standard complaints process includes reviewing the taxpayer's issue and working with the taxpayer in resolving the issue. When an error is found, Inland Revenue will communicate the updated information with all affected approved credit reporting agencies. In addition, for exceptional circumstances, Inland Revenue has the ability to urgently communicate with all approved credit reporting agencies.

In addition, the amendment gives the Commissioner the authority to approve an appropriate organisation to become an approved credit reporting agency. The Commissioner can also revoke the approval to protect the integrity of the tax system. Approval would be given after the Commissioner is satisfied that the organisation has the capable systems, processes and safeguards to appropriately handle any taxpayer information exchanged with the Commissioner. Likewise, an approved credit reporting agency could choose to no longer receive this information and duly notify the Commissioner and request that their approval be revoked. Any approval or revocation would be publicly notified by way of the *Tax Information Bulletin* and Inland Revenue's website.

[30] During the original consultation it was estimated that the exchanges would be fortnightly or monthly. Following feedback from the consultation and from submitters at the select committee stage of the Bill, Inland Revenue will schedule the exchanges weekly, which will provide greater clarity on the reportable unpaid tax.

The Commissioner is required to annually publish the number of taxpayers, who in the previous tax year:

- received a formal notice;
- had their tax information disclosed;
- were previously disclosed, but who paid the total amount of reportable unpaid tax in the previous tax year.

The requirement also includes any other matter relating to the Commissioner's use of this section that the Commissioner decides is appropriate to publish.

Application date

The amendment came into force on 1 April 2017.

Detailed analysis

Section 85N outlines when an amount of reportable unpaid tax can be exchanged with credit reporting agencies.

Reportable unpaid tax threshold

Before the taxpayer's information can be considered for disclosure, the taxpayer must first owe the required quantum of reportable unpaid tax.

The required quantum is either:

- an amount greater than the amount prescribed by an Order in Council; or
- the unpaid amount has been outstanding for more than a year, and the proportion of the amount exceeds the taxpayer's assessable income for the previous 12 months by 30 percent or more.

The first threshold allows the Commissioner to disclose reportable unpaid tax that is significant in size. To provide some proportionality, this would be when the taxpayer does not appear have the financial ability to easily resolve the reportable unpaid tax in the foreseeable future (within the 30-day notice period). This amount will be set (and can be varied) by an Order in Council.

The second threshold allows the Commissioner to consider taxpayers when the debt is significant in relation to the size of the taxpayer and has been unpaid for some time. To determine the taxpayer's annual assessable income, the Commissioner will exercise judgement and use available information to reasonably determine the taxpayer's assessable income for the previous year. The Commissioner has a range of financial information available, including previously filed tax returns.

Reasonable efforts

Under section 85N(2)(c), the Commissioner can only initially disclose the taxpayer's information when the Commissioner has already made reasonable efforts to recover the unpaid tax. "Reasonable efforts" includes when Inland Revenue has previously undertaken manual collection activities to try and resolve the tax debt. This is when the Commissioner has previously notified the taxpayer of the tax debt and the Inland Revenue officer has initiated or actively engaged in one or more manual collection activities with the taxpayer, with the tax debt remaining unpaid.

These activities include where Inland Revenue has communicated the debt information to the taxpayer via phone or written correspondence, and had one or more verbal discussions with the taxpayer about resolving their tax debt. These activities also include when an Inland Revenue officer has explored one or more of the available options, but the tax debt remains unresolved. These options include:

- considering an instalment arrangement;
- formal relief of the tax debt via a write-off; or
- the taxpayer has been given an opportunity by Inland Revenue to pursue lending opportunities with a third party, to repay the tax debt.

On-going "reasonable efforts" also includes if, before the initial disclosure of tax debt information to approved credit reporting agencies, the taxpayer advises the Commissioner that they are actively resolving the tax debt by way of attempting to secure suitable finance or conducting an ordinary windup of the business, and the Commissioner is confident that in the near future, it will be successful. This is because the lender or purchaser would be already engaged in their due diligence (including the taxpayer's financial position) and disclosing the tax debt would not be appropriate.

The Commissioner is responsible for ensuring the criteria and thresholds are applied consistently.

Example

Peter's Biscuits Limited produces bespoke chocolate biscuits. However, over the years, the market has stagnated, with the business now experiencing low sales and excessive inventory. With late payment penalties and UOMI, the tax debt of GST and PAYE has now grown to over $185,000.

Over the last eight months, in addition to statements, notices and letters, Inland Revenue has had several conversations with the director about the growing tax debt, including attempting to arrange a formal instalment arrangement and the director previously attempting to borrow sufficient funds from their bank. These efforts have not been successful in resolving the tax debt.

The company's other creditors are unaware of the tax debt, and are extending additional trade credit to the company, on the understanding that there are sufficient assets to support the lending.

The Commissioner is considering disclosing the taxpayer's tax debt to the approved credit reporting agencies so these other creditors are made aware of the tax debt and will be able to make more informed commercial decisions about whether to further extend lending to the company. The debt is reportable unpaid tax as it consists of GST and PAYE debt that is not being disputed, is not under a formal instalment arrangement and the Commissioner does not have an application for a write-off or remission under consideration. Inland Revenue has made "reasonable efforts" to resolve the debt.

The tax debt meets the reportable unpaid tax threshold as the company's tax debt is greater than the amount previously prescribed in an Order in Council ($150,000).

The two directors are personally served a formal notice, giving the company 30 days to attempt to resolve the debt. After 30 days, the company's circumstances remain unchanged, demonstrating that the debt cannot be repaid in the foreseeable future. Inland Revenue subsequently discloses the taxpayer's information to approved credit reporting agencies.

The Commissioner continues to periodically disclose the taxpayer's tax debt information in order to maintain the accuracy of the information contained in the credit report.

LATE PAYMENT PENALTY

Section 139B(2B) of the Tax Administration Act 1994

An amendment has been made to section 139B of the Tax Administration Act 1994 that means Inland Revenue will no longer impose a 1% monthly incremental late payment penalty on unpaid tax from Goods and Services Tax (GST), income tax and Working for Families tax credit overpayments. The amendment only applies to certain tax periods.

Background

The changes give effect to announcements made in Budget 2016 to no longer impose the incremental late payment penalty on certain GST, income tax and Working for Families tax credit overpayments.

The amendment does not affect the Commissioner's requirement to impose the initial late payment penalty and use-of-money interest (UOMI) when a taxpayer has not met a tax liability by the due date.

Key features

The amendment to section 139B(2) of the Tax Administration Act 1994 means that when a taxpayer does not pay their tax liability by the due date, the taxpayer will no longer incur the 1% incremental late payment penalty, if the unpaid tax is incurred in one of the described tax periods.

The relevant periods are:

- GST tax periods ending within 8 days of 31 March 2017;
- GST periods ending after 31 March 2017;
- provisional tax and income tax for the 2017–18 or later income years; and
- Working for Families tax credit overpayments for the 2017–18 or later income years.

The amendment encompasses taxpayers that have a GST taxable period that ends up to seven days before 31 March 2017. These are taxpayers that have had this alternative taxable period end date approved by the Commissioner (under section 15E(2) of the Goods and Services Tax Act 1985).

The amendment will ensure that taxpayers who are overpaid Working for Families tax credits and who have amounts recoverable under sections MF 5 or MF 6 of the Income Tax Act 2007 will not also be liable for the incremental late payment penalty, where the unpaid amount is in the 2017–18 or later income years. This applies whether the person was over credited during the tax year or had their entitlement amended at a later date.

The amendment also includes any other unpaid civil penalties that may be imposed and have become unpaid tax, in the described periods. This is to clarify that the Commissioner cannot impose incremental late payment penalties on unpaid civil penalties that relate to the tax types and tax periods affected by this change.

This amendment does not apply if the unpaid tax liability does not reside in one of the described tax periods. The taxpayer will also continue to incur the incremental late payment penalty as imposed by the current rules.

Application date

The amendment came into force on 1 April 2017.

TRANSITIONAL REGULATIONS

Section 227B of the Tax Administration Act 1994

The Tax Administration Act 1994 has been amended to provide a regulation-making power to resolve any potential transitional problems arising during the period when Inland Revenue's older FIRST software system and its new START system are both in use.

Background

As part of Inland Revenue's business transformation programme, changes to legislation and administrative processes will be required in a range of areas, including supporting the upgrade to new technology. Some issues will require a prompt regulatory response to avoid potential delays in the transformation process.

Ideally, any problems arising from the transformation would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases this will be both necessary and achievable, as it is anticipated that tax Bills will be introduced during the transformation process. The problem is that the process leading up to when a Bill can be introduced can be complex and time-consuming. This could result in valuable taxpayer and Commissioner resources being tied up pursuing outcomes that are not consistent with the policy intent, when a remedy for the problem cannot be achieved quickly. Any delays before enactment could also cause uncertainty for taxpayers. There is also a risk that the process could create hurdles that may delay the business transformation process, impede the orderly transition from the old system (FIRST) to the new system (START) and increase the cost of transformation.

Key features

The purpose of the new regulation-making power is for matters:

- relating to the application of the Tax Administration Act 1994 that arise during the period of co-existence of the FIRST and START software systems; and
- that are necessary in order to achieve an orderly transition to the new software platform and are consistent with the purposes of the Inland Revenue Acts.

The regulations may not:

- cause a taxpayer's liability to be more than the liability they would have if no regulations were made;
- alter or affect the application of the care and management provisions in sections 6 and 6A, the information provisions in sections 16 to 21, the secrecy provisions in Part 4, a shortfall penalty under sections 141 to 141K, or a criminal penalty under sections 143 to 148;
- directly or indirectly remove or diminish the rights of a taxpayer under the disputes provisions in Part 4A, the provisions for determinations under Part 5, binding rulings under Part 5A, the objection and challenge provisions in Parts 8 and 8A, or the provisions relating to remission, relief, and refunds in Part 11; and
- have retrospective application.

Before recommending the making of a regulation, the Minister of Revenue must be satisfied that:

- the regulations are necessary to achieve the purpose of the regulation-making power, are consistent with the purposes of the Inland Revenue Acts, and are the only legislative option that is practicable in the circumstances; and

- a consultative process has been undertaken with persons or organisations that represent taxpayers that it is reasonable to consult with, for a period of at least four weeks.

Application date

The amendment came into force on the date of enactment, being 21 February 2017.

Detailed analysis

Scope of the regulation-making power

The scope of the regulation-making power is limited to tax administration issues that arise during the period of co-existence of FIRST and START. The power does not allow regulations to be made that amend the substantive rules in the Income Tax Act 2007 and the Goods and Services Tax Act 1985. The power is further limited by specific safeguards (discussed below).

Regulations can only be made under the provision when they are "necessary" to achieve an orderly transition to Inland Revenue's START system. This is intentionally narrower than many other similar transitional regulation-making provisions, which allow regulations to be made that are "necessary or desirable" for the relevant purposes.[31]

The provision cannot result in a taxpayer being subject to any liability exceeding the taxpayer's liability under the Tax Administration Act 1994 if no regulation had been made under the provision. For example, the limitation means that a taxpayer cannot be liable for a greater liability under a penalty provision or interest provision in the Tax Administration Act that would not have existed but for the regulation. Regulations cannot be made that affect a liability under the Income Tax Act or Goods and Services Tax Act.

The regulations must be consistent with the purposes of the Inland Revenue Acts. In addition, more specifically, any regulations made under the provision cannot directly or indirectly remove or diminish the rights of a taxpayer under the disputes provisions in Part 4A, the provisions for determinations under Part 5, binding rulings under Part 5A, the objection and challenge provisions in Parts 8 and 8A, or the provisions relating to remission, relief, and refunds in Part 11.

Certain sections of the Tax Administration Act have been excluded from the scope of the provision:

- the care and management provisions in sections 6 and 6A;
- the information provisions in sections 16 to 21;
- the secrecy provisions in Part 4;
- a shortfall penalty under sections 141 to 141K; and
- a criminal penalty under sections 143 to 148.

The sections have been excluded because they will not be affected by the system changes, and given that the relevant administrative rules and processes are not dependent on automation, it is very unlikely that there will be an urgent need to fix any issues in relation to these provisions.

Some provisions within Part 9 have been included within the scope of the provision. The relevant provisions relate to the penalties that are imposed automatically. The regulation-making power can, however, only be used when there is no increased liability under the relevant penalty provision for taxpayers as a result of the relevant regulation. In other words, the empowering provision can only amend the application of the relevant penalties when it would maintain or decrease the amount of the penalty.

Application of regulations

A regulation made under the provision can:

- provide for transitional and savings provisions concerning the coming into force of provisions affecting the administration of the Tax Administration Act;
- prescribe how provisions of that Act must be applied or modified in order to achieve an orderly transition to the new software system and which are consistent with the purposes of the Inland Revenue Acts;
- specify how provisions of the Tax Administration Act, including definitions, do not apply, or apply with modifications or additions, or both;
- specify that terms have the meaning given to them by the regulations;
- specify that provisions repealed or amended in the Tax Administration Act are to continue to apply;
- specify categories of persons who may be exempted from some or all of an obligation under the Tax Administration Act; and

[31] See for example the transitional regulation-making powers in the Child Support Amendment Act 2013, Financial Markets Conduct Act 2013, Local Government (Auckland Transitional Provisions) Act 2010, Student Loan Scheme Act 2011, and the Financial Advisers Act 2008.

- provide for any other matters that may be required in order to achieve an orderly transition to the new software system, which are consistent with the purposes of the Inland Revenue Acts.

Consultation process

Before any regulations are made under the provision, consultation must be undertaken with persons or organisations that represent taxpayers that it is reasonable to consult with. This is likely to include consultation with professional accounting and legal bodies that it is reasonable to consult with. The minimum consultation period is four weeks.

Time limitations

A regulation must include a date on which it is revoked, which must be no later than three years after the date on which it was made. The three-year period is intended to be the maximum timeframe for transitional regulations, rather than the default period. The three-year period was considered appropriate given the complex nature of the transformation and the fact that the different parts of the tax system will be in different software systems for some time.

The regulation-making power and any regulations then in existence expire on 31 December 2021. The expiry date is over the three-year lifespan suggested under the Regulations Review Committee guidelines, and reflects the fact that there may be transitional issues until the last processes and rules are transferred over to the START system. There may be administrative processes that need to be carried on in both software systems until then.

EXCHANGE OF INFORMATION BETWEEN THE COMMISSIONER AND THE REGISTRAR OF COMPANIES

Sections 81(4)(s) and 85M of the Tax Administration Act 1994

The Tax Administration Act has been amended, to allow Inland Revenue to share information with the Companies Office (within the Ministry of Business, Innovation and Employment). The amendment allows information to be shared for the purpose of preventing, detecting, investigating or providing evidence of, certain serious offences under the Companies Act 1993 (those punishable by a term of imprisonment of four years or more). The change is part of the Government's Better Public Services initiative to improve the quality of public sector services through the sharing of targeted information between specified government agencies.

Background

The Companies Office is responsible for enforcing a number of provisions of the Companies Act 1993. It has determined that for certain serious offences, information held by Inland Revenue on taxpayers and on entities would be of assistance in helping the Companies Office perform its obligations under the Act.

Under section 81 of the Tax Administration Act 1994, Inland Revenue officers must maintain secrecy. There was previously no specific exception in the Act to allow the sharing of information to the Companies Office for the purposes of enforcing company law.

Key features

The Companies Office may, from time to time, request information from Inland Revenue to enable it to detect and investigate an offence under sections 138A(1), 377, 382(4), 383(6), 385(9), 385AA(9) or 386A(2) of the Companies Act 1993. Also, Inland Revenue may proactively provide information in relation to these offences. In more detail, these offences are:

- a serious breach of a director's duty to act in good faith and in the best interests of the company (section 138A(1));
- false statements (section 377);
- breaches of various orders and prohibitions from directing, promoting and/or managing companies (sections 382(4), 383(6), 385(9) and 385AA(9)); and
- breach of restrictions on involvement with phoenix companies (section 386A(2)).

Following a request for information, Inland Revenue may share information if it considers that:

- the Registrar or the Commissioner reasonably suspects that an offence has been, is being, or will be committed; and
- the information is relevant for the purposes of preventing, detecting, investigating or providing evidence of, the offence; and
- Inland Revenue is satisfied that the information is readily available, that it is reasonable and practicable to communicate the information, and that communication of the information is in the public interest.

Application date

The amendment came into force on the date of enactment, being 21 February 2017.

BUSINESS TAX – OTHER MATTERS

Motor vehicle expenditure of close companies

Sections CD 32, CX 6, CX 17, DB 7, DB 8, DE 1 and DE 2 of the Income Tax Act 2007

The amendment enables close companies that operate like a sole trader to use an alternative to fringe benefit tax (FBT) when accounting for the business and private use of a motor vehicle owned by the company and used by a shareholder-employee. Close companies that meet certain criteria can elect to use the motor vehicle expenditure rules in subpart DE instead of paying FBT on the value of the private use of the vehicle by the shareholder-employee.

Background

Close companies that provide a shareholder-employee with a motor vehicle for private use are required to register and pay FBT for that benefit, subject to certain exemptions. Sole traders and partners in a partnership who use a motor vehicle in a similar way are not required to register and pay FBT. Instead, these taxpayers apportion their motor vehicle expenditure between business and private use under the motor vehicle expenditure rules in subpart DE. These differences in treatment for what is essentially the same benefit (the private use of a motor vehicle) arise because of the different entities involved.

Key features

The amendments provide an alternative to FBT for certain close companies by inserting a new exclusion into section CX 17. Section CX 17 is the section in the FBT rules that deals with benefits provided to shareholder-employees. Under the new exclusion, section CX 17 will not apply when the close company makes a motor vehicle available to a shareholder-employee for their private use and elects to apply subpart DE for the motor vehicle and the shareholder-employee. This means these close companies will effectively be treated like a sole trader for accounting for the private use of a motor vehicle by a shareholder-employee.

Close companies can only use this alternative when the only non-cash benefit they are providing to employees is the availability of a motor vehicle for private use by a shareholder employee.

The election will apply only to new motor vehicle arrangements between close companies and shareholder-employees, and will continue to apply until the close company stops using the motor vehicle for business use or until the close company disposes of the motor vehicle.

Under these amendments, a close company meeting the criteria above can elect to apply the motor vehicle expenditure rules in subpart DE. Subpart DE provides methods for calculating the proportion of business use of a motor vehicle. This proportion of business use forms the basis for the amount of motor vehicle expenditure that can be deducted. Section DE 1 has been amended to enable a close company that makes an election under section CX 17 to use the rules in subpart DE to measure the business use of the motor vehicle by its shareholder-employee. Ordinarily these methods are not available to companies. The close company will use the proportion of business use by the shareholder-employee to calculate the amount of their deduction for motor vehicle expenditure.

Section DE 2 has also been amended to include a special interest allocation rule. This rule ensures interest on amounts used to fund, directly or indirectly, expenditure for the business use of a motor vehicle is included in the motor vehicle expenditure, and subject to the rules in subpart DE. This amendment only applies to close companies that have elected to use the motor vehicle rules in subpart DE and is needed because of the automatic interest deduction rules for companies in sections DB 7 and DB 8. These sections have also been amended to ensure the amount of interest deductible on motor vehicle arrangements appropriately reflects the amount of business use of the motor vehicle. This means that if the close company is using this option then any interest on amounts used to fund directly or indirectly expenditure for the business use of a motor vehicle is not deductible under sections DB 7 or DB 8.

When a close company uses this new option and transfers the value of the private non-deductible portion of the motor vehicle expenditure to the shareholder-employee by debiting their shareholder current account, the value of the private use of the motor vehicle by the shareholder-employee will not be a dividend. The debit to the shareholder current account is required so the non-deductible private portion of the motor vehicle expenditure is not treated as a dividend to the shareholder-employee.

If this entry is not made, the non-deductible private portion of the motor vehicle expenditure funded by the close company may be a dividend to the shareholder-employee.

In some circumstances a GST adjustment may be required to reflect any difference between the actual proportions of business and private use of the motor vehicle and the intended proportions of business and private use of the motor vehicle.

Application date

The amendments apply for the 2017–18 and later income years.

Example

Mary is the controlling shareholder of Mary's Home Interiors Ltd, which has a 31 March balance date. Mary's Home Interiors Ltd is a close company and Mary is the only employee. On 1 April 2017, the company provides Mary with a new vehicle for both business and unlimited private use. During the 2017–18 income year, it is expected that Mary's business use of the vehicle will be 60 percent and the total motor vehicle expenditure for the year is estimated to be $4,250. This includes an amount of interest on the loan that the company used to finance the cost of acquiring the new vehicle. The cost price of the vehicle was $40,000.

The company makes an election under amended section CX 17(4B) to use the motor vehicle expenditure rules in subpart DE. The company will use the proportion of business use of the vehicle by Mary to apportion the motor vehicle expenditure. Mary maintains a logbook where she records details of her business use of the vehicle. This results in the business not claiming 40 percent of the total motor vehicle expenditure of $4,250 ($1,700).

At the end of the 2017-18 income year, a debit entry is made to Mary's shareholder current account for the value of the motor vehicle expenditure that relates to her private use of the motor vehicle.

If the company uses the logbook records to determine the percentage of intended use and actual use of the motor vehicle for GST purposes, no GST change of use adjustments should be required.

Increased threshold for taxpayer self-corrections of minor errors

Section 113A of the Tax Administration Act 1994

The amendment increases the self-correction threshold for minor errors in section 113A of the Tax Administration Act 1994 from $500 to $1,000. This allows taxpayers to correct simple errors of up to $1,000 in their next tax return, after the discovery of the error.

Background

Section 113A of the Tax Administration Act 1994 allows taxpayers to self-correct a minor error in an income tax return, a FBT return or a GST return. The error must be caused by a clear mistake, simple oversight, or mistaken undertaking on the taxpayer's part and prior to this amendment the total discrepancy caused by the error must have been $500 or less. Interest and penalties will usually be payable on the shortfall corrected by the Commissioner.

Key features

The amendment increases the minor error threshold from $500 to $1,000. The other requirements of section 113A of the Tax Administration Act 1994 remain unchanged.

Application date

The amendment came into force on 1 April 2017.

Simplified calculation of deductions for dual use vehicles and premises

Sections DB 18AA, DE 2, DE 2B, DE 3, DE 4, DE 12 and EE 49 of the Income Tax Act 2007

Amendments allow taxpayers to use a simplified method for the calculation of deductions for premises and vehicles that are used for both business and other purposes, such as private use.

Background

Small business owners often use their vehicles and premises for both business and private purposes. This requires these taxpayers to apportion any expenditure that is used both for business and private purposes. A common example of this type of expenditure is expenditure related to running a home office. This expenditure could include electricity, phone/internet and insurance, for example.

For vehicles used in a small business, taxpayers have the choice of using a mileage rate to account for the business and private use of a motor vehicle or actual costs. These rules are contained in subpart DE of the Income Tax Act 2007.

Key features

Vehicles

Subpart DE of the Income Tax Act 2007 has been amended to modify and extend the current mileage rate method. Under these amendments this method is renamed as the kilometre rate method for determining a taxpayer's deductions for a vehicle used for both business and private purposes. Prior to this amendment, the mileage rate method in section DE 12 could only be used if the business use of the vehicle was less than 5,000 km per income year.

Section DE 12 has been amended so that under the kilometre rate method, taxpayers will deduct a fixed amount per kilometre travelled for business purposes, based on rates published by Inland Revenue. This is instead of deducting any actual motor vehicle expenditure costs.

The rates will be:

- set by reference to industry figures, and based on the average per kilometre cost for the average vehicle;
- divided into two tiers –
  - the first tier will provide for the recovery of both the vehicle's fixed costs and its per kilometre costs ;and
  - the second tier will provide for the recovery of the per kilometre costs only (as the fixed costs of vehicle ownership would be over-deducted with increasing usage if a single fixed rate were used); and
- published by Inland Revenue and updated each year to ensure the rates are accurate.

The first tier of rates applies to the total distance travelled (including for both business and personal purposes) up to a specified limit. To calculate the deduction for this tier, taxpayers will multiply the total kilometres travelled (to which the first tier applies) by the proportion of business use for the vehicle and the income year. The product of that calculation will then be multiplied by the kilometre rate for the first tier to produce the deductible amount.

The calculation is repeated for the second tier of rates. That is, the total kilometres travelled (to which the second tier of rates applies) will be multiplied by the proportion of business use for the vehicle and the income year. The product of this calculation is then multiplied by the kilometre rate for the second tier to give the deductible amount. The deductible amounts for the first and second tiers of rates are then added together to determine the taxpayer's total deduction for their business use of the vehicle for that income year.

The logbook requirements in sections DE 6 to DE 11 remain the same. This means that taxpayers can keep a logbook for a three-month representative test period to determine a vehicle's proportion of business use for the next three years.

The kilometre rate method is optional, and taxpayers may elect to use it on a per-vehicle basis. However any election must be made when the tax return is filed for the year in which the vehicle is acquired. The election is non-revocable, so taxpayers cannot switch between methods for the same vehicle (although they may apply different methods to different vehicles). This is because it would be too complex to account for depreciation if a taxpayer switched methods, given that separate depreciation deductions are not claimed under the new method and no depreciation recovery income arises on sale.

Taxpayers who own a vehicle they use partly for business purposes may switch to the new method for the 2017–18 income year. This is provided they do not dispose of the vehicle in that income year.

Section EE 49 has also been amended to confirm that there is no depreciation recovery income where a taxpayer has elected to use the kilometre rate method for claiming a deduction for motor vehicle expenditure.

Premises

A new section has been added to subpart DB to provide a method for calculating a deduction for premises used for both business and private use. Section DB 18AA sets out the square metre rate method that determines the amount of a deduction for the proportion of business use of a premises that is used partly for business purposes and partly for other purposes. The "premises" refers to the building and does not include any curtilage. There are two parts to this calculation for the amount of the deduction.

The first part of the calculation for the deduction is calculating an amount based on the area of the premises used primarily for business purposes. In order to use the square metre method, the taxpayer has to determine the area of their premises (in square metres) that is both separately identifiable and used primarily for business purposes. This area is then divided by the total area of the premises to give the business proportion. The business proportion is then multiplied by the square metre rate to give the first part of the deduction amount.

The square metre rate will be:

- set by Inland Revenue, based on the average cost of utilities per square metre of housing, but excluding mortgage interest and rates or rent; and
- updated each year.

The second part of the deduction amount is the business proportion of total premises costs. The business proportion is the same area as calculated in the first part above and is then divided by the total area of the premises in square metres to give the business proportion of the premises. This is then multiplied by the total costs of the premises to give the second part of the deduction amount for the square metre rate method. Total premises costs is the total amount of actual mortgage interest, rates and rent that the person has paid in respect of the premises in the income year. The reason this part of the deduction is calculated separately is because mortgage interest, rates and rental costs are too variable to be included in the square metre rate.

Both amounts are then added together to give the total amount of the deduction under the square metre rate method.

No other deduction in relation to the premises is allowed for taxpayers who use this method.

Taxpayers may elect to use the new method for an income year by using it to calculate their deductions in their income tax return. There are no restrictions on the ability of a taxpayer to choose the method.

Application date

These amendments apply for the 2017–18 and later income years.

Example 1: Dual use vehicles

Mr Smith is a real estate agent who uses his personal car for business purposes.

Mr Smith buys a new car and elects to use the kilometre rate method to calculate his deduction for motor vehicle expenditure. Mr Smith has kept a log book for the first three months of the year, which shows a proportion of business to total kilometres of 0.55. Over the entire year Mr Smith has driven 30,000km.

The rates that Inland Revenue has published are 75 cents per km for the first 10,000km and 25 cents for every km thereafter (these rates are indicative only).

Mr Smith needs to calculate his deductions for each tier of rates, and then add them together.

The formula to calculate his deductions for each tier is:

Total kilometres travelled (to which the tier applies) × business proportion × tier rate

Applying this formula, Mr Smith makes the following calculations:

First tier: 10,000 km × 0.55 business use × $0.75/km = $4,125

Second tier: (30,000 total km – 10,000km) × 0.55 business use × $0.25/km = $2,750

Adding the results for each tier together gives $4,125 + 2750 = $6,875. Therefore Mr Smith can claim a deduction for motor vehicle expenditure of $6,875.

Example 2: Dual use premises

Mr Smith has a room in his house which is set aside as an office. He uses the office primarily for business purposes. Mr Smith decides to calculate his deductions for this office using the new square metre rate method. The office has an area of 10m², while Mr Smith's house has a total area of 100m².

Inland Revenue has set the fixed rate for premises at \$100/m² (this amount is indicative only).

Mr Smith calculates the first part of the square metre rate method using the square metre rate. To do this he simply multiplies the area of his office (in square metres) by the fixed rate. Accordingly, the first part of Mr Smith's deduction is:

10m² × \$100/m² = \$1,000

Mr Smith next calculates the second part of his deduction for his mortgage interest and rates (as Mr Smith owns his house). To do this, he calculates the fraction of his house occupied by his office. He then multiplies his actual mortgage and interest costs by that fraction.

The fraction of Mr Smith's house that is occupied by his office is: 10m² office ÷ 100m² house = 0.10 (or 10%).

Mr Smith's mortgage interest for the year is \$20,000 and his rates are \$3,000. Therefore Mr Smith's second deduction is: (\$20,000 + \$3,000) × 0.10 office fraction = \$2,300.

Adding the two amounts together, Mr Smith has a total deduction for his office of \$1,000 + \$2,300 = \$3,300. Accordingly he can claim a deduction for his home office of \$3,300 under the square metre rate method.

Remove the requirement to renew RWT exemption certificates annually

Sections 32H and 32I of the Tax Administration Act 1994

The amendments to sections 32H and 32I of the Taxation Administration Act 1994 enable most resident withholding tax (RWT) exemption certificates to be issued for an unlimited period.

Background

Section 32E of the Tax Administration Act 1994 sets out the requirements to be met in order for a taxpayer to apply for a certificate of exemption for RWT. Prior to this amendment, Inland Revenue's practice was to require some taxpayers to apply for certificates of exemption annually. Annual renewal was required if the taxpayer was applying for a RWT exemption certificate on the grounds that it had tax losses, a refund of over \$500 RWT or estimated annual gross income of over \$2 million.

Key features

The amendments enable more RWT exemption certificates to be issued for an unlimited period. Taxpayers who qualify for a certificate of exemption under section 32E(2)(j) of the Tax Administration Act 1994 (taxpayers who estimate their next tax year's gross income will be over \$2 million) will continue to have their certificates issued with an end date.

Inland Revenue will still have the discretion to issue exemption certificates for a limited period in exceptional circumstances, such as where the taxpayer has a poor compliance history.

Taxpayers are still required to surrender their exemption certificates when they fail to meet the basis for eligibility on which they were granted. Inland Revenue also retains its ability to cancel an exemption certificate. Taxpayers will also be required to indicate in their income tax returns for the 2017–18 and later tax years whether they are still eligible to hold their exemption certificates on the basis on which they were granted.

Application date

The amendments came into force on 1 April 2017.

Increased threshold for annual FBT returns from \$500,000 to \$1 million of PAYE/ESCT

Sections RD 60 and RD 61 of the Income Tax Act 2007

The threshold for calculating and returning FBT on an annual basis has increased from \$500,000 to \$1 million of PAYE/ESCT.

Background

The FBT rules contain an option for small businesses to calculate and return FBT on an annual basis instead of a quarterly basis. In order to use this option, a small business must have had combined PAYE and employers' superannuation contribution tax (ESCT) obligations of no more than \$500,000 per year. This threshold is increasing to \$1 million.

Key features

Amendments to sections RD 60 and RD 61 of the Income Tax Act 2007 increase the threshold for calculating and returning FBT on an annual basis. The new threshold is $1 million of gross tax for both PAYE income payments and employers' superannuation cash contributions under sections RA 5(1)(a) and (c).

Application date

The amendment applies for the 2017–18 and later income years.

Modifying the 63-day rule on employee remuneration

Section EA 4 of the Income Tax Act 2007

An amendment to section EA 4 enables taxpayers to choose whether to apply the deferred payment of employment income rule in section EA 4.

Background

The deferred payment of employment income rule in section EA 4 requires taxpayers to keep track of payments of expenditure on employment income paid within 63 days of the end of the income year. Any payment of employment income paid within this 63-day period is deductible in the earlier income year.

Key features

The amendment gives taxpayers the option to apply the deferred payment of employment income rule. If a taxpayer chooses not to apply the rule, the amendment makes it clear the taxpayer must deduct payments of employment income that are paid in that income year. This means that for taxpayers not using the deferred payment of employment income rule, any accrued employee expenditure at the end of the income year such as holiday pay or bonuses will not be deductible if the amounts have not been paid by the end of the income year.

Application date

The amendment applies for the 2017–18 and later income years.

COLLECTING TAX ON EMPLOYEE SHARE SCHEMES USING THE PAYE SYSTEM – TECHNICAL CLARIFICATIONS

Sections CE 2(11), RD 6(3) and YA 1 of the Income Tax Act 2007

Technical changes have been made to sections CE 2(11) and RD 6(3) relating to when an employer elects to withhold tax under the PAYE rules on benefits an employee receives under an employee share scheme. The changes affect the timing and calculation of PAYE for employers that are generally required to provide Inland Revenue with a PAYE income payment form on the 20th of the month in which PAYE is withheld.

Background

The Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016 simplified the collection of tax on employment income in the form of benefits under an employee share purchase agreement. From 1 April 2017, the general PAYE collection rules in the Income Tax Act and disclosure rules in the Tax Administration Act have been changed to:

- require employers to report the value of any benefits an employee receives under a share purchase agreement via the employer monthly schedule (EMS); and
- allow employers to choose to use the PAYE system and withhold tax on any employment income an employee receives under a share purchase agreement.

The changes to sections CE 2(11) and RD 6(3) provide additional clarity on how tax is withheld under the new rules.

Key features

The term "pay period" in section CE 2(11) has been replaced with "PAYE payment period form period" to avoid confusion between an employer's payroll system and the timing of PAYE payments set out in section RD 22(2) of the Income Tax Act 2007. The term "PAYE payment period form period" is now defined in section YA 1 by reference to the obligation on employers to which section RD 22(2) applies.

To assist employers calculating tax on extra pays in section RD 17 for a benefit under an employee share scheme, section RD 6(3) specifies the date when the benefit is treated as paid.

The collective operation of sections CE 2(11), RD 6(3) and RD 7B means that PAYE (when it is withheld from a share benefit) is calculated under section RD 17 on the basis that the employee share benefit is paid on the first day of the PAYE income payment period immediately following the PAYE income payment period in which the benefit vests in the employee. This does not affect the relevant date for valuing the share benefit, which would remain as the date on which the shares vest in the employee. This outcome is relevant only to employers to which section RD 22(2) applies.

For all other employers, the share benefit is treated as paid on the date the benefit vests in the employee.

Application date

The changes apply for the 2017–18 and later income years.

INTEREST-FREE STUDENT LOANS

Section 25 and schedule 1 of the Student Loan Scheme Act 2011

The Student Loan Scheme Act 2011 has been amended by introducing new provisions under which student loans are interest-free for overseas-based borrowers. The borrowers must be in receipt of a New Zealand Government-funded scholarship for full-time study or an internship undertaken overseas. Borrowers are required to provide evidence of their scholarship from Education New Zealand in order to be eligible for an interest-free student loan.

The changes are part of a broader package of funding policies to support studying overseas and develop new international connections and capabilities for New Zealanders.

Background

Student loans are interest-free for New Zealand-based borrowers. When student loan borrowers become overseas-based they also become subject to interest on the outstanding balance of their student loan. However, some overseas-based borrowers may be entitled to have their student loan remain interest free if they meet certain conditions such as studying full-time overseas at Level 7 or above on the New Zealand Qualifications Framework.

The circumstances in which student loans may remain interest-free while overseas have been extended to borrowers who are recipients of qualifying New Zealand Government-funded scholarships. The scholarship recipients may be studying full-time or undertaking an internship that is full-time or part-time with study. If a borrower's partner accompanies them overseas that partner may also be eligible for their loan to remain interest-free.

The new circumstances address an inconsistency, in terms of level and length of study, between support for scholarship recipients and the existing overseas study interest rules. They address the inconsistency by aligning funding eligibility across Government funding to support international connections and improving transparency for students.

Key features

New circumstances in which the Commissioner of Inland Revenue may treat borrowers as being physically in New Zealand (and eligible for interest-free student loans) are when the borrower is in receipt of a qualifying Government-funded scholarship, such as the Prime Minister's Scholarships for Asia and Latin America and is either studying full-time overseas or undertaking an internship that is either full-time or part-time with study.

Eligibility of borrowers for interest-free loans will be determined by Inland Revenue based on evidence a borrower must provide from Education New Zealand (ENZ) that they are in receipt of a qualifying government-funded scholarship.

Application date

The new provisions for interest-free loans apply from the date of enactment, being 21 February 2017.

Detailed analysis

What is the effect of a student loan borrower being treated as being physically in New Zealand?

While student loans are interest-free for borrowers who are physically in New Zealand (New Zealand-based borrowers), borrowers are subject to interest on the outstanding balance of their loans when they are overseas-based. However, the Commissioner is able to treat certain borrowers who are overseas as being physically in New Zealand in specified circumstances so the student loan remains interest free. Being treated as New Zealand-based while overseas also means that a borrower's student loan repayments are calculated with regard to their ability to pay rather than on the outstanding balance of their student loan.

When are borrowers entitled to the new treatment?

The two new provisions which will allow the Commissioner of Inland Revenue to treat borrowers as being physically in New Zealand (New Zealand-based) and eligible for interest-free student loans are set out in section 25(1)(ia) and section 25(1)(ib) of the Student Loan Scheme Act. Borrowers must be overseas undertaking study or on an internship that meets the requirements set out in schedule 1, clauses 9A and 9B of the Student Loan Scheme Act.

What are the requirements to be met by borrowers?

The requirements to be met by overseas-based borrowers in order to be treated as New Zealand-based are supported by new definitions, contained in clause 1 of schedule 1. To be a qualifying Government-funded scholarship, a scholarship must be in respect of study or an internship that is partially or fully funded by a government department or a Crown agent. It must also have been assessed by Education New Zealand (ENZ) as being qualifying for the purpose of the Act.

ENZ will provide the scholarship recipient with confirmation that the scholarship meets the requirements of either of the two new provisions for student loans to remain interest-free. It will confirm that the borrower has been awarded a qualifying Government scholarship; whether it is for study or an internship; and the start and end dates of the study or internship period. There will be no charge for the verification.

The requirements to be met by borrowers are set out in new clause 9A when the scholarship is for full-time study and clause 9B when the scholarship is for an internship.

Consistently with the other situations in which interest exemptions are available, if a scholarship recipient's partner accompanies them overseas, and the partner is also a student loan borrower, the partner may also be eligible for their loan to be interest-free. The amendment to clause 6(1)(d)(ii) requires the borrower to provide Inland Revenue with evidence of the relationship and that their partner has accompanied them overseas.

The effect of being treated as New Zealand-based is that borrowers (and eligible partners) must complete an annual return of income in accordance with existing requirements so their minimum repayments may be calculated. If income details are not provided borrowers and partners may be ineligible for an interest-free loan.

LAND PROVISIONS

Bright-line test

Section CB 6A of the Income Tax Act 2007

An amendment has been made to section CB 6A, the provision that sets out the two-year bright-line test for residential land. The amendment clarifies the start-date for the bright-line test when there is a change of trustee for a trust.

Background

The general rule in section CB 6A is that the two-year bright-line period starts when an instrument of transfer is registered under the Land Transfer Act 1952. When land is held in a trust and there is a change of trustee, there has to be a transfer of the land because the land is held in the names of the trustees not the trust.

Key features

The amendment clarifies that the registration of an instrument of transfer when there is a change of trustee for a trust will not re-start the two-year bright-line period. It was not intended that these types of transfers would re-start the bright-line period because the trust property remains in the trust and there is no disposal for income tax purposes.

Application date

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

Land remedials

Definition of "offshore RLWT person"

Section YA 1 of the Income Tax Act 2007

An amendment has been made to the definition of "offshore RLWT person" in section YA 1. The amendment ensures that for limited partnerships and look-through companies the definition applies at the partnership/company level.

Background

The recently introduced residential land withholding tax (RLWT) rules apply to certain disposals of residential land by someone who is an "offshore RLWT person". For limited partnerships and look-through companies, the definition applied at the level of the partners/owners of effective look-through interests. This was not the policy intent.

Key features

Land owned by limited partnerships or look-through companies is registered in the partnership or company name, because those entities have separate legal status. It is the partnership or company that disposes of land that it owns, and it is therefore the partnership or company that will be liable for any RLWT, despite their look-through status for most tax purposes. The amendment ensures that for limited partnerships and look-through companies the definition of "offshore RLWT person" applies at the partnership/company level, as originally intended.

Application date

The amendment came into force on 1 July 2016 – the date the RLWT legislation came into force.

Certificate of exemption requirements

Section 54E of the Tax Administration Act 1994

An amendment has been made to section 54E, which sets out the requirements for a person being able to get an RLWT certificate of exemption. The amendment enables newly formed special purpose entities to apply for an exemption certificate if they are associated with a taxpayer who has the required record of complying with their tax obligations.

Background

RLWT does not apply if the person disposing of the residential land holds an RLWT certificate of exemption for the land. A certificate of exemption may be issued to someone in the business of developing land, dividing land into lots or erecting buildings. Unless a security has been provided, one of the requirements for a certificate of exemption is that the person has complied with their tax obligations for the two years before their application. Newly created entities that have been specifically set up for a particular development would not be able to meet the two-year tax compliance requirement. Often these special purpose entities will be associated with other taxpayers who would be able to meet the requirement.

Key features

The amendment enables newly formed special purpose entities to apply for an exemption certificate if they are associated with a taxpayer who has the required record of complying with their tax obligations. The associate can be a company in the same group of companies or, if the person is a limited partnership, a partner of the partnership.

Application date

The amendment came into force on 1 July 2016 – the date the RLWT legislation came into force.

RLWT – transfers of relationship property

Section RL 1 of the Income Tax Act 2007

An amendment has been made to section RL 1, which imposes an obligation to pay RLWT on certain disposals of residential land. The amendment ensures that RLWT does not need to be paid when there is a transfer of residential land on a settlement of relationship property.

Background

Relationship property may be transferred from one party to another following the breakdown of a relationship. Relationship property will often include residential land. The two-year bright-line test will not apply to the transfer of residential land on a settlement of relationship property, because the transfer is treated as being for an amount that equals the cost of the land to the transferor. But because of the way the RLWT rules work, an amendment was needed to ensure that an RLWT obligation does not arise on these transfers.

Key features

The amendment ensures that RLWT does not need to be paid when there is a transfer of residential land on a settlement of relationship property.

Application date

The amendment came into force on 1 July 2016 – the date the RLWT legislation came into force.

RLWT calculation – GST

Section RL 4 of the Income Tax Act 2007

An amendment has been made to section RL 4, which sets out how much RLWT must be paid or withheld if the RLWT rules apply. The amendment clarifies that the RLWT calculation is net of GST.

Background

It is intended that RLWT is calculated net of GST, because income and deductions are net of GST for income tax purposes. This was not clear in the RLWT formula.

Key features

The amendment clarifies that the amounts in the RLWT formula are GST exclusive.

Application date

The amendment came into force on 1 July 2016 – the date the RLWT legislation came into force.

RLWT rules – drafting issue

Section RL 2 of the Income Tax Act 2007

An amendment has been made to section RL 2, which sets out when vendors must pay RLWT and how the payment is made.

Background

"Residential land purchase amount" is a defined term in the legislation, and it is this amount that triggers an RLWT liability. A remedial amendment was needed in section RL 2 where the word "amount" was omitted from the term "residential land purchase amount".

Key features

The amendment clarifies by inserting the word "amount" where needed.

Application date

The amendment came into force on 1 July 2016 – the date the RLWT legislation came into force.

Technical amendment – application date for section CB 15B(3)

Section CB 15B of the Income Tax Act 2007

An amendment has been made to clarify the application date of the recently enacted amendments to section CB 15B(3).

Background

Section CB 15B(3) specifies the date land is acquired through the exercise of an option. That provision was amended by the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016. It was intended that the amendment would apply from the date of enactment of that Act.

Key features

The amendment ensures that the amendment to section CB 15B(3) applies from the date of enactment of the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016, as intended.

Application date

The amendment reinstating the original wording of section CB 15B(3) came into force on 22 November 2013 – the date section CB 15B came into force.

The amendment bringing in the new wording of section CB 15B(3) came into force on 14 May 2016 – the date the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016 came into force.

AGENCY RULES: UNINTENDED LEGISLATIVE CHANGE CORRECTED

Section HD 3 of the Income Tax Act 2007

Section HD 3 contains an unintended legislative change arising from the rewrite of income tax legislation.

Key features

The agency rules in subpart HD apply to a person declared to be an agent for income tax purposes on behalf of principals who are not present in, or are a non-resident of, New Zealand. Some of the agency rules relate solely to business activity and some relate to non-business activity, such as rentals collected on behalf of investment in New Zealand property by non-residents.

The rewrite of the agency rules into the Income Tax Act 2007 inadvertently restricted all of the agency rules to business situations. This has resulted in an inability to collect income tax from agents where a business activity does not exist. The amendment corrects this unintended legislative change.

Application date

The amendment applies from the beginning of the 2008–09 income year. However, a "savings" provision protects tax positions taken by taxpayers in reliance on the law as it was before this amendment.

Order in Council

Use-of-money interest rate changes

The use-of-money interest rates on underpayments and overpayments of taxes and duties have changed, in line with market interest rates. The new rates are:

- underpayment rate: 8.22% (previously 8.27%)
- overpayment rate: 1.02% (previously 1.62%)

The new rates came into force on 8 May 2017.

Rates are reviewed regularly to ensure they are in line with market interest rates. The new rates are consistent with the Reserve Bank floating first mortgage new customer housing rate and the 90-day bank bill rate.

The rates were changed by Order in Council on 27 March 2017.

Taxation (Use of Money Interest Rates) Amendment Regulations 2017 (LI 2017/55)

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 17/02: Income tax – deductibility of farmhouse expenses

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.

This Interpretation Statement considers the deductibility of expenditure relating to a farmhouse that forms part of a farming business. The Interpretation Statement withdraws and replaces a number of *Public Information Bulletin* and *Tax Information Bulletin* items about certain expenses for which farmers can claim deductions (these are listed at [24] of this Interpretation Statement). According to these items, the Commissioner has permitted full-time farmers to claim full deductions for both rates and interest payable on farm mortgages, and has allowed all farmers to claim 25% deductions on expenses relating to the farmhouse. The Commissioner considers that the deductions allowed in those items are no longer appropriate and the general rules of deductibility and apportionment, as explained in this Interpretation Statement, will apply.

However, in situations where the compliance costs of calculating the private use element far outweighs any likely deduction, the Interpretation Statement allows some sole traders and partners of partnerships to claim an automatic 20% deduction (a more realistic amount) for farmhouse expenses and 100% deductions for rates and interest. These deductions are allowed when the value of the farmhouse is 20% or less than the total value of the farm. This Interpretation Statement will apply from the commencement of a taxpayer's 2017-2018 income year.

Summary

1. The Commissioner has a number of long-standing policies concerning the deductibility of expenses relating to farms and farmhouses. These policies appear to have originated in the 1960s at a time when farm ownership and operating structures were generally less complicated than they are today. As part of the process of reviewing the existing policies, the Commissioner has also sought to clarify the principles for deductibility across a variety of ownership structures.
2. In reviewing these policies, the Commissioner's main concern is to allow farmers to deduct farmhouse expenses that are business related, while ensuring that deductions are not claimed for expenses that are private in nature. In undertaking this exercise, the Commissioner needs to balance the strict application of the law with the associated compliance costs of doing so, while maintaining equity between taxpayers and protecting the integrity of the tax system.
3. Farming businesses may be structured in many different ways. Whether farmhouse expenses are deductible will depend on a number of factors, including who owns the farmhouse, who operates the farming business, and who lives in the farmhouse.
4. Against this background, deductions being obtained for private expenditure is most likely in situations where:
   - the person incurring the farmhouse expenditure lives in the farmhouse; and
   - the value of the farmhouse represents a significant proportion of the total value of the farm.
5. A person living in the farmhouse and incurring the farmhouse expenditure will be a natural person and could be any of the following:
   - a sole trader (see [77]);
   - a partner in a partnership (see [77];
   - an employee or shareholder-employee (see [112]);
   - a shareholder, beneficiary or other natural person not involved in the farming business (see [114]).

INTERPRETATION STATEMENTS

6. While the principles in this Interpretation Statement apply mainly to sole traders and partners in partnerships, a summary of the treatment of farmhouse expenses incurred by different entities in different situations may be found in the table at [126].

General principles

7. The deductibility of expenditure relating to a farmhouse (farmhouse expenses) must be determined under the general permission, general limitations and the specific deduction provisions in Part D of the Income Tax Act 2007. A deduction is available under the general permission only where the expenses have the necessary relationship both with:
   - the taxpayer concerned, and
   - the gaining or producing of their assessable income or with the carrying on of a business for that purpose.
   - It is a matter of degree and a question of fact whether a sufficient relationship exists. For example, a person operating a farming business may claim a full deduction for farmhouse expenses where the farmhouse is rented out or provided to an employee.
8. It is important to note that this Interpretation Statement is only concerned with farming operations that are businesses. For more information on what constitutes a business, please see the discussion of *Grieve v CIR* (1984) 6 NZTC 61,682 (CA) in the commentary to BR Pub 09/06: "Lease surrender payments received by a landlord – Income tax treatment" (*Tax Information Bulletin* Vol 21, No 6 (August 2009): 37).
9. If an expense satisfies the general permission, it may still not be deductible due to the application of the general limitations. For example, a person is denied a deduction for an expense to the extent to which it is of a capital nature. For farmhouse expenses, the private limitation may apply where the person incurring the expenses lives in the farmhouse. When a person lives in a farmhouse, any expense they incur on that farmhouse must be apportioned between business and private use based on the particular facts in each case. This is the same treatment that applies for expenses incurred by other taxpayers on private houses when they are used for business purposes, eg, home offices.
10. Some expenses may be deductible under a specific provision in Part D. For example, most companies need no nexus with income to claim a deduction for interest expenses. For other taxpayers, interest expenses will still need to satisfy the general permission to give rise to a deduction.
11. Generally, for all farming businesses, where it is possible to **dissect** an expense into deductible and non-deductible amounts, that method should be used first (see [62] and [66] below). Where an expense relates to both the business and private use of the farmhouse, **dissection** may be impractical or impossible. In this situation, the expense will need to be **apportioned** on some fair and reasonable basis between the business and private portions of the expense. **Apportionment** will be necessary when a farmer lives in the farmhouse and uses part of it for business purposes (see table at [126] below). This will generally arise, for example, when sole traders and partners of partnerships live in the farmhouse. The Commissioner considers that apportionment of farmhouse expenses based on time and space would generally be an appropriate method. This is consistent with other businesses.
12. On the other hand, some expenses will be incurred on the farm as a whole (including the farmhouse). In this situation, the proportion of the expenses that relate to the private use of the farmhouse must be determined. An apportionment based on time and space might not provide an accurate division between expenses that relate to the farmhouse and expenses that relate to the rest of the farm. The Commissioner considers that an appropriate method of apportionment is one that is based on the value of the farmhouse (being the value of the farmhouse, curtilage and improvements to the farmhouse) as a proportion of the total value of the farm and improvements. The Commissioner will accept a formal valuation or a reasonable estimate of the values of the farmhouse (including curtilage and improvements) and farm. The relative costs of the farm and farmhouse may be a reliable approximation of value at a particular point in time.
13. These general principles apply to all farming businesses, regardless of the type of entity incurring the expenditure and the ownership structure of the farming business.

Reducing compliance costs where private element of farmhouse expenses is minimal

14. For larger farming businesses carried on by sole traders and partners in partnerships, the farmhouse may represent a small proportion of the overall value of the farm. In this situation, the private element of any expenses will be minimal. However, the compliance costs associated with calculating deductions for interest and other farmhouse expenses outweigh the tax consequences of any deductions available. Accordingly, this Interpretation Statement sets out circumstances in which the Commissioner will accept prescribed levels of deductions for farmhouse expenses incurred by sole traders and partners who live in the farmhouse. This is instead of always requiring deductions for farmhouse expenses to be based on actual use.

15. The Commissioner will accept a practical approach to apportioning farmhouse expenses in this situation. This approach has been developed to mitigate compliance costs for farms with a low private-use element. The approach is based on a new distinction between:

- farming businesses where the value of the farmhouse (including curtilage and improvements) is 20% or less of the total value of the farm (Type 1 farms); and
- farming businesses where the value of the farmhouse (including curtilage and improvements) is more than 20% of the total value of the farm (Type 2 farms).

16. The value of the farmhouse (including curtilage and improvements) and farm can be used to determine the extent of the private use of the farmhouse. The Commissioner will accept a formal valuation or a reasonable estimate of the values of the farmhouse (including curtilage and improvements) and farm. To reduce compliance costs, the respective costs of the farmhouse and farm may also be used to determine whether the farm is a Type 1 or Type 2 farm.

17. The term "curtilage" refers to the land surrounding the farmhouse that is used primarily for private purposes. The curtilage may be fenced (like a backyard) or not. If the curtilage is not fenced, the Commissioner will accept a reasonable estimate of the curtilage area and its value.

18. Farmers who live in the farmhouse on Type 1 farms may determine whether expenses are deductible under the general permission and general limitations as set out in this Interpretation Statement. However, the Commissioner will also accept that 20% of the farmhouse is used for business purposes without any supporting evidence. As a result, such farmers can claim 20% of all farmhouse expenses as deductible business expenses. In addition, these farmers may continue to claim 100% of the interest costs relating to the farmhouse and 100% of rates.

19. Farmers who live in the farmhouse on Type 2 farms must determine whether expenses are deductible under the general permission and general limitations as set out in this Interpretation Statement.

Telephone rental and fixed line charges

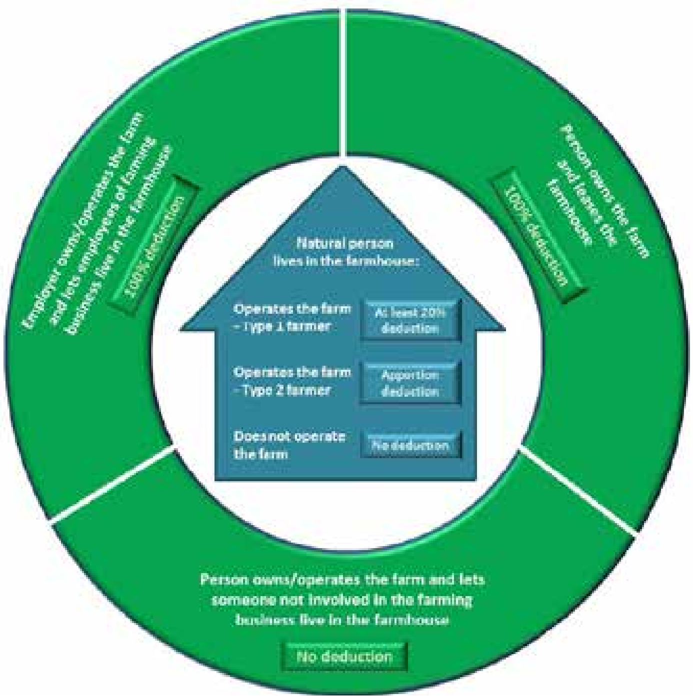
20. Farmers who operate their business from home may claim 50% of their telephone rental charges, unless they can show that the actual business use of the telephone is greater than 50%. This is the existing practice for other home based businesses.

Approach in this Interpretation Statement

21. This Interpretation Statement applies the general principles to two broad situations:

- a person who lives in the farmhouse and incurs farmhouse expenses (see discussion from [74] below); and
- a person who does not live in the farmhouse and incurs farmhouse expenses (see discussion from [116] below).

22. The following diagram provides a general summary of the treatment of farmhouse expenses incurred by persons in various capacities. The diagram assumes that the other general limitations (other than the private limitation) do not apply. Unless otherwise indicated, a person can include a sole trader, partner in a partnership, trustee, or company. For more detailed summaries, please refer to the tables at [111] and [126].



Introduction

23. This Interpretation Statement is about the Commissioner's long-standing policy to allow full-time farmers to claim full deductions for rates and interest and all farmers to claim 25% of the expenses relating to the farmhouse (eg, insurance, electricity, repairs and maintenance, etc). Many of these concessions were negotiated with the farming industry in the 1960s. This Interpretation Statement updates and replaces these concessions with a revised approach.

24. This Interpretation Statement supersedes all previous Inland Revenue statements on farmhouse expenses. The following publications state that the Commissioner will allow farmers to claim deductions for certain expenses incurred on the farmhouse:

- 'New Arrangements With Farmers — Some Further Deductions', *Public Information Bulletin* No 14 (September 1964): 6;
- 'Farmers leasing Farm from Trust – Rental Portion Applicable to Dwellings', *Public Information Bulletin* No 89 (January 1977): 4;
- 'Policies We're Reviewing', *Tax Information Bulletin* Vol 4, No 8 (April 1993): 3;
- 'Farmhouse interior decoration expenses – deductibility', *Tax Information Bulletin* Vol 6, No 14 (June 1995): 24; and
- 'Farm lease payments – deduction for cottage', *Tax Information Bulletin* Vol 7, No 8 (February 1996): 32.

25. In addition to the specific deductions set out in these publications, it was generally accepted that the Commissioner would allow a deduction of 25% of farmhouse expenses to reflect the use of the farmhouse as an administrative base for the farm.

26. The following deductions for farmhouse expenses have generally been accepted as available to farmers:

- mortgage interest on the farm, including the farmhouse, for full-time farmers (100%);
- rates (100%);
- home telephone rental for full-time farmers (100%);
- electricity for the farmhouse (25%);
- repairs and maintenance for the farmhouse (25%);
- farmhouse interior decoration expenses (25%);
- general deduction for expenses for the farmhouse (25%); and
- rent applicable to a farmhouse when the farmer leases the farm (25%).

27. To the extent that they refer to these deductions, the publications listed at [24] are updated and replaced by this Interpretation Statement.

28. In addition, the policy statement on 'Telephone rental deductions for businesses based at home', *Tax Information Bulletin* Vol 5, No 12 (May 1994): 2, explicitly did not apply to farmers. The policy statement said that farmers could continue to claim 100% deductions for the cost of telephone rental for farmhouse telephones. This Interpretation Statement modifies that position and farmers are now allowed the same deductions as other taxpayers. All farmers who operate their business from home must now follow the existing practice of other home based businesses and claim up to 50% of the cost of telephone rental, unless they can show that the actual business use of the telephone is greater and a higher percentage is justified.

Analysis

29. This Interpretation Statement considers the deductibility of farmhouse expenses. A farmhouse is one example of a building on a farm property. As with other types of expenses, the starting point is the general permission and general limitations. In addition, specific deductions may be available under other provisions in Part D.

30. The first part of this Interpretation Statement sets out the general principles of deductibility and discusses some of the specific deduction provisions that might apply to farmhouse expenses. In addition, this Interpretation Statement discusses some methods of dissecting and apportioning farmhouse expenses that are not fully deductible. This Interpretation Statement then applies these principles to two broad scenarios:

- the farmhouse expenses are incurred by a person living in the farmhouse; and
- the farmhouse expenses are incurred by a person not living in the farmhouse.

31. The second part of this Interpretation Statement then sets out a practical approach to apportioning farmhouse expenses that the Commissioner will accept.

32. The final part of this Interpretation Statement sets out some examples that illustrate how the general principles and the practical approach set out in this Interpretation Statement apply to some common situations.

Deductibility of expenses

33. There are many different ways that farming businesses are structured. Whether farmhouse expenses are deductible will depend on a number of factors, including who owns the farmhouse, who operates the farming business and who lives in the farmhouse.

34. It is important to note that this Interpretation Statement is only concerned with farming operations that are businesses. For more information on what constitutes a business, please see the discussion of *Grieve v CIR* (1984) 6 NZTC 61,682 (CA) in the commentary to BR Pub 09/06: "Lease surrender payments received by a landlord – Income tax treatment" (*Tax Information Bulletin* Vol 21, No 6 (August 2009): 37).

35. The general rules for deductions are contained in subpart DA of the Act. In short, the deductibility of an expense is determined as follows:

    - The general permission must be satisfied in any situation where a deduction is sought by a taxpayer (s DA 1).
    - Even if the general permission is satisfied, a deduction for such an expense may be denied if a general limitation applies (s DA 2).
    - However, the subparts that follow subpart DA provide for specific rules that may apply to supplement or override both the general permission and the general limitations (s DA 3(1) and (4)).

36. In addition, as will be discussed below, some expenses may need to be dissected or apportioned between deductible and non-deductible amounts.

General permission

37. The general permission is contained in s DA 1. Section DA 1(1) and (2) provide:

    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**.

38. Section DA 1 therefore provides two bases for deduction:

    - The first is for expenses or losses incurred by the person in deriving their assessable or excluded income (see s DA 1(1)(a)).
    - The second is for expenses or losses incurred in carrying on a business for the purpose of deriving assessable or excluded income (s DA 1(1)(b)).

39. The leading authorities on the principles of deductibility are the Court of Appeal judgments in *CIR v Banks* (1978) 3 NZTC 61,236 and *Buckley & Young Limited v CIR* (1978) 3 NZTC 61,271. These cases are authority for the following principles:

    - A deduction is available under the general permission where the expense has the necessary relationship both with the taxpayer concerned and with either the gaining or producing of their assessable income or with the carrying on of a business for that purpose. This requires a focus on the relationship between the advantage gained or sought to be gained by the expense and the income-earning process, which in turn requires a focus on the true character of the payment made.
    - It is a matter of degree and a question of fact whether such a sufficient relationship exists.
    - The phrase "to the extent to which" contemplates that an expense may be apportioned between its deductible and non-deductible components.

40. For an expense to be deductible under s DA 1, a sufficient relationship (nexus) must exist between the expense incurred by the taxpayer and the deriving of assessable income or the carrying on of a business for the purpose of deriving assessable income.

41. It is important to note that in determining the deductibility of an expense, the focus is on the character of the expense from the point of view of the taxpayer who has incurred the expense. This may be determined by identifying the advantage gained or sought to be gained by the taxpayer in incurring that expense.

42. Whether an expense is deductible will depend on the particular facts of each case. In the context of farmhouse expenses, it will be necessary to determine who has incurred the expense and in what capacity.

43. However, a deduction is not available under s DA 1 to the extent the general limitations in s DA 2 apply.

General limitations

44. The general limitations are contained in s DA 2. The limitations that will most commonly apply to farmhouse expenses are the capital limitation, private limitation and employment limitation. Section DA 2 relevantly provides:

> **DA 2 General limitations**
>
> *Capital limitation*
>
> (1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.
>
> *Private limitation*
>
> (2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.
>
> …
>
> *Employment limitation*
>
> (4) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving income from employment. This rule is called the **employment limitation**.
>
> ….
>
> *Relationship of general limitations to general permission*
>
> (7) Each of the general limitations in this section overrides the general permission.

45. This Interpretation Statement primarily considers the application of the private limitation and the employment limitation to determine whether an expense is deductible. Under s DA 2(2), a person is denied a deduction for an expense to the extent to which it is of a private or domestic nature. Under s DA 2(4), a person is denied a deduction for an expense to the extent to which it is incurred in deriving income from employment.

46. However, in any given situation, it is important to determine whether any of the other general limitations apply. This will depend on the particular facts of each case. For example, under s DA 2(1), a person is denied a deduction for an expense to the extent to which it is of a capital nature. The capital limitation is beyond the scope of this Interpretation Statement. For more information and analysis on the application of the capital limitation, please see IS 12/03: "Income Tax – Deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68.

47. The general limitations override the general permission: s DA 2(7). However, the general limitations need not be applied unless the expense first has the requisite nexus with deriving income and satisfies the general permission.

Special provisions relating to interest

48. Deductibility of interest is determined under ss DB 6 and DB 7. Section DB 6 overrides the capital limitation, but the general permission must still be satisfied and the other general limitations still apply: s DB 6(4). Section DB 7 (which applies to most companies) supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply: s DB 7(8).

49. Under s DB 6, a person is allowed a deduction for any interest incurred, except for penalty interest under s DB 1. An interest deduction is not subject to the capital limitation. However, any interest deduction must still satisfy the general permission in s DA 1 (ie, a nexus must still exist between the interest incurred and the assessable income derived) and is subject to the other general limitations (including the private limitation).

50. How the borrowed capital was used must be considered when determining whether interest incurred is deductible: *Pacific Rendezvous Limited v CIR* (1986) 8 NZTC 5,146 (CA); *Eggers v CIR* (1988) 10 NZTC 5,153 (CA); and *CIR v Brierley* (1990) 12 NZTC 7,184 (CA). As Richardson J suggests in *Banks* at 61,246, determining the deductibility of interest will ordinarily

involve the same considerations as determining the deductibility of other expenses under the general permission. Under the current legislation, this is because interest expenses must satisfy the general permission to be deductible: s DB 6(4).

51. Under s DB 7, most companies need no nexus with income to claim a deduction for interest expenses. Where s DB 7 does not apply to a particular company (for instance qualifying companies), interest expenses will need to satisfy s DB 6 to be deductible.

Deductions available under other regimes

52. The following discussion briefly explains some other regimes in the Act that may apply when considering the deductibility of farmhouse expenses.

Employer pays employee remuneration

53. Expenses incurred by an employer on employee remuneration are generally deductible to the employer under the general permission. This is because employee remuneration expenses, such as salary and wages, are an ordinary incidence of carrying on a business. (However, some employee expenses may still be subject to the capital limitation: *Christchurch Press Company Ltd v CIR* (1993) 15 NZTC 10,206 (HC).)

54. Expenses incurred by the employer in providing accommodation to an employee in connection with their employment (s CE 1B) and maintaining that accommodation will also generally be deductible to the employer under the general permission. The value of accommodation provided to an employee under s CE 1B is income to the employee under s CE 1. Commissioner's Statement CS 16/02 – Determining "Market Rental Value" of Employer-Provided Accommodation provides guidance on determining the value of farm housing provided to employees.

Employer incurs expenses on account of, or reimburses, an employee

55. An employer may reimburse an employee for expenses the employee incurs in connection with their employment. Alternatively, an employer might pay for expenses incurred by an employee as "expenditure on account" of that employee. In both these situations, the employee has incurred the expenses. These amounts will be deductible to the employer if the general permission is satisfied.

56. These amounts will be exempt income to the employee to the extent the employee would be allowed a deduction if they incurred the expenses and if the employment limitation did not exist: ss CW 17(1) and (2). This is provided the expenses are not private or capital in nature. Where the expenditure on account or reimbursement does not satisfy ss CW 17(1) or (2), those amounts will be assessable to the employee under s CE 1.

Employer provides employee with fringe benefit

57. Costs incurred by an employer in providing a fringe benefit will be deductible if the general permission is satisfied.

58. In some situations an employer may incur expenses to provide an employee with a non-monetary benefit in connection with their employment. An example might be where an employer incurs and pays the employee's power bill (or other expenses for the private use of a farmhouse). The "on premises exemption" in s CX 23 does not apply because "premises of a person" is defined to exclude premises occupied by an employee of the person for residential purposes. Therefore the employee has received an unclassified fringe benefit under s CX 37. The employer will be liable for fringe benefit tax to the value of the fringe benefit.

Company pays dividends to shareholders and shareholder-employees

59. Dividends paid by a company are not deductible. A dividend is a transfer of value from a company to a shareholder where the cause of the transfer is their shareholding in the company. An example might be where a company allows a shareholder (who is not an employee) to live in a farmhouse for no rent or for rent less than market value. Another example is where a company pays any private expenses on behalf of a shareholder in that company or incurs expenses that would have been private had they been incurred by the shareholder. Such amounts will be dividends to the shareholder. A dividend derived by a person is income of the person: s CD 1.

60. Section CD 20(1) provides that an unclassified fringe benefit provided by a company to a shareholder-employee may be treated as a dividend if the company so elects.

Appropriate methods of apportionment

61. The general permission and general limitations use the phrase "to the extent". It is well accepted that this phrase indicates that an expense may need to be apportioned into deductible and non-deductible amounts. An example is where the farmhouse is used for both business and private purposes. Apportionment may also be necessary under a specific deduction provision (if that provision does not override the general permission or general limitations).

62. The leading case on apportionment in New Zealand is *Banks*. In *Banks*, Richardson J drew a distinction between dissecting and apportioning expenses. This distinction was drawn from the Australian High Court decision of *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 at 59. Where an expense has distinct and severable deductible and non-deductible components, it can be divided or dissected. An amount may be dissected where there are distinct and severable components that are subject to different tax treatments (such as assessable and non-assessable income, or revenue and capital, or private expenses). Dissection would be possible, for example, for a composite amount that relates to an itemised invoice or to several things or services with discrete parts.

63. In contrast, where a single outlay serves two or more objects indifferently, dissection is impractical. Here, apportionment on a fair and reasonable basis (such as time, area or some other quantifiable basis) applies.

64. In *Buckley & Young*, Richardson J considered at 61,282, what apportionment method would be appropriate for a house used for both business and private purposes:

> The circumstances of the particular case will usually determine what is the most apt way of deciding how much of the expenditure is attributable to the deductible item. For example, where an asset, such as a house or car, is used for both business and private purposes, the apportionment of total expenses may fairly be based on the use (and in some cases availability for use) for business purposes and private purposes respectively. Even so, it is impossible to prescribe any precise formula applicable to all cases. Each such case depends on its own circumstances. It is the yardstick of factual use, or availability for use for business purposes, that satisfies the requirements that the apportionment must be fair, not arbitrary, and must be done as a matter of fact.

65. The Commissioner considers that, based on *Banks*, a general rule of apportionment of farmhouse expenses is not appropriate and each case must be considered on its own facts.

66. The Commissioner considers that where it is possible to dissect expenses into deductible and non-deductible amounts, that method should be used first. This may be possible, for example, with premiums for insurance policies on wholly private assets, private toll calls, and rates charges that are specifically charged on private houses (ie, the amounts are charged per house). Where dissection is impractical or impossible, the expense will need to be apportioned on some fair and reasonable basis.

67. Where an expense relates only to the farmhouse, and cannot be dissected between deductible and non-deductible amounts, the expense will need to be apportioned. The Commissioner considers that apportionment of farmhouse expenses based on time and space will generally be an appropriate method. This was the method used by the taxpayer in *Banks* and accepted by the Court of Appeal. Such expenses would include household electricity, repairs and maintenance, telephone rental and fixed line charges, insurance policies that only cover the farmhouse and other expenses incurred only on the farmhouse.

68. Some expenses will be incurred on the farm as a whole (including the farmhouse). In this situation, the proportion of the expense that relates to the private use of the farmhouse must be determined. Also, some expenses will be calculated with reference to the value of the farm and improvements. In these situations, the Commissioner considers that an appropriate method of apportionment is one that is based on the value of the farmhouse (being the value of the farmhouse, curtilage and improvements to the farmhouse) as a proportion of the total value of the farm and improvements. This is because an apportionment based on time and space might not provide an accurate division between expenses that relate to the farmhouse and expenses that relate to the rest of the farm. An example where an area-based apportionment might not be appropriate is where the farmhouse is a small proportion of the area of the farm, but a high proportion of the value of the farm.

69. The Commissioner will accept a formal valuation or a reasonable estimate of the values of the farmhouse (including curtilage and improvements) and farm. In order to reduce compliance costs, the Commissioner will also allow farmers to use the respective costs of the farm and farmhouse. The costs of the farm and farmhouse must be comparable and show the relative market values at a particular point in time.

70. However, the time and space method could still be used to calculate how much of the farmhouse expenses are used for business purposes and are therefore deductible. Expenses that might warrant using such a method include mortgage interest attributable to the farmhouse.

71. In addition to the deductions allowed under the Act as set out above, the Commissioner will accept an updated approach to the apportionment of farmhouse expenses in place of the original policies. This approach is explained below under the heading 'Practical Approach' (see below from [91]).

Application of the general principles

72. As noted above, the Commissioner's various policy statements have applied for many years. Some of the policy statements assume that the farm is owned by an individual or partnership. These days, farm ownership is often more complicated,

with companies and trusts involved in the ownership structure. Further, often the farming assets are not owned by the entity that carries on the farming business. All of these different structures and options make it difficult for the Commissioner to set out the correct tax treatment for each variation.

73. However, having considered a range of different structures, the Commissioner considers that the most useful distinction to draw for people incurring farmhouse expenses is between those where the person incurring the expenditure lives in the farmhouse and those where they do not.

Farmhouse expenses incurred by a person living in the farmhouse

74. The following analysis considers the deductibility of farmhouse expenses incurred by each type of person living in a farmhouse. Because of similarities of treatment, they are grouped as follows:

- sole traders and partners in partnerships who operate the farming business;
- employees and shareholder-employees;
- shareholders, beneficiaries of trusts and other natural persons who are not involved in operating the farming business.

75. The occupants of the farmhouse might own or rent the farmhouse, or they might be provided the farmhouse as accommodation (eg, under a trust deed, or as part of their employment).

76. It is important to remember that for the general permission to be satisfied, the person incurring the expense must be deriving income from the farm or farmhouse.

Sole traders and partners in partnerships who operate the farming business

77. Some farms are owned and operated by sole traders or partnerships. Such persons may live in the farmhouse and derive business income from the farm. The following analysis shows that where they incur farmhouse expenses:

- expenses incurred on one's own shelter are inherently private;
- no distinction exists between full-time and part-time farmers; and
- farmhouse expenses may be deducted to the extent that the farmhouse is used for the farming business.

Expenses incurred on one's own shelter are inherently private

78. In *CIR v Haenga* (1985) 7 NZTC 5,198, Richardson J in the Court of Appeal considered that an expense properly characterised as consumption (eg, food, clothing and shelter) is not incidental and relevant to the derivation of income merely because it is necessary in the sense that it maintains the individual and, in turn, his or her ability to perform his or her employment.

79. In *Hunter v CIR* (1989) 11 NZTC 6,242 (HC), the taxpayer sought to claim a deduction for the expenses he incurred in relocating to a new city where those expenses exceeded his reimbursement entitlement. The expenses related to the sale of his family home and the purchase of a new one. The issue was whether these expenses were private or domestic in nature and therefore not deductible. McGechan J in the High Court held that the relocation expenses were incurred primarily for private or domestic purposes. McGechan J suggested that determining where the line falls is an exercise of judgment based on the facts of the case, at 6,260:

> As *Haenga's* case illustrates, an expenditure which in its essential character may seem a paradigm case of private or domestic expenditure may as a result of other factors be characterised otherwise. It is useful to look for nexus between the expenditure, and the income production or intended income production. In the end, whether there is sufficient nexus to take an expenditure out of the private or domestic character and into a deductible work-related classification involves a value judgment. It may simply be putting the matter another way to apply a test distinguishing between pre-requisite to earning income, and actual participation in the income earning process. In the end, an overall view must be taken. As with the ancient jibe about obscenity, at times private or domestic expenditure can be difficult to define but not unduly difficult to recognise.

80. That a farmhouse is essentially private in nature is supported by the following Taxation Review Authority (TRA) decisions: *Case E11* (1981) 5 NZTC 59,064; *Case F47* (1983) 6 NZTC 59,801; *Case G13* (1985) 7 NZTC 1,048; *Case J33* (1987) 9 NZTC 1,190; *Case K57* (1988) 10 NZTC 465. In addition, two TRA cases concerning private houses on business premises support this view: *Case H12* (1986) 8 NZTC 168, and *Case L81* (1989) 11 NZTC 1,468.

81. There is a clear prohibition in the Act for deductibility of an expense that is, in reality, of a private or domestic nature. The cases, including the Court of Appeal decision in *Haenga*, seem clear that expenses on food, clothing and shelter are private or domestic in nature when incurred by the person obtaining the benefit of the expenses. If the expense is private in nature, then no deduction is permitted for that expense because the general limitations override the general permission. Like the enquiry into statutory nexus, the enquiry into whether an expense is of a private or domestic nature is focused primarily on the advantage sought by the payer.

82. Despite clear authority for the proposition that an expense incurred on one's own house is private or domestic in nature, it is sometimes suggested that farmhouse expenses are fully deductible on the basis that a farmhouse is a "necessary adjunct" to a farming business. It is argued that the farmhouse is the "headquarters" for the farm and is needed on the farm to allow the farmer to be available at all hours of the day to see to stock and machinery and to afford a measure of security against theft and vandalism. Some support for this argument is found in the TRA decision in *Case N35* (1991) 13 NZTC 3,308.

83. In *Case N35*, the taxpayer was involved in a horticultural venture with her husband. One of the issues in this case was whether the deductions claimed for interest payments on the mortgage on the property should be apportioned to exclude any private or domestic expenses. Keane DJ acknowledged that the land was not fully committed to the income-earning process and observed that the "predominant use" of the land was for business purposes. However, Keane DJ went on to accept the taxpayer's contention that the home was a "necessary adjunct" to the business. Keane DJ then concluded that the land devoted to the home "does not warrant separate treatment". Keane DJ's decision that no adjustment was required appears to be based on the view that the private use of the land was of a "de minimis" nature.

84. However, the general proposition is that an expense must be apportioned between business and private purposes. The Commissioner considers that the decision in *Case N35* should be confined to its facts and should not be relied on as authority for the proposition that a farmhouse is a necessary adjunct to the farming operation. The Commissioner considers that proposition is not sustainable and is inconsistent with the cases mentioned above, including the Court of Appeal decision in *Haenga*.

85. Therefore, an expense incurred on one's own house, including a farmhouse, is inherently private in nature. But, that is not to say that parts of a farmhouse cannot be used for business purposes. Like the home office in *Banks*, to the extent that a farmhouse is used for business purposes, the expenses incurred on the farmhouse will have the requisite nexus with the derivation of income. In this situation, the expenses on the farmhouse would need to be apportioned between business and private use.

No distinction between full-time and part-time farmers

86. In the past, the Commissioner has allowed certain deductions based on whether a farmer worked on the farm on a full-time or part-time basis. However, there is no distinction in the Act between full-time and part-time farmers.

87. Instead, a deduction for an expense is allowed to the extent to which the general permission is satisfied and the general limitations do not apply. Therefore, if the taxpayer can prove that the expense has the requisite nexus with the derivation of income, then that expense will be deductible. The fact that a farmer only works part time on their farm is not relevant.

Farmhouse expenses may be deducted to the extent that they are used for the business

88. Parts of the farmhouse may be used for business purposes. In this situation, an expense relating to a farmhouse needs to be apportioned between business and private use. An example might be where a farmer uses a room in the farmhouse as an administrative base for the farming business.

89. The farmhouse could have a designated room used for the farming business (eg, a home office). Alternatively, different parts of the house may be used at different times for business purposes. For example, the kitchen may be used to provide lunch to farm workers each day, or the dining room may be used to do the farm accounts once a week.

90. In these situations, there will need to be apportionment between business and private use of the farmhouse (see above from [61]).

Practical Approach

91. Where it is possible to dissect an expense into deductible and non-deductible amounts, that method should be used first (see [62] and [66] above). For example, a telephone bill might list toll calls made. Only expenses relating to toll calls made for business purposes will be deductible. Where dissection is impractical or impossible, the expense will need to be apportioned on some fair and reasonable basis between the business and private portions of the expense. Apportionment will be necessary when a farmer lives in the farmhouse and uses part of it for business purposes (see table at [126]). This will generally arise, for example, when sole traders and partners of partnerships live in the farmhouse.

92. In reviewing the old policies, the Commissioner's main concern is to allow farmers to deduct farmhouse expenses that are business related, while ensuring that deductions are not claimed for expenditure that is private in nature. In undertaking this exercise, the Commissioner needs to balance the strict application of the law with the associated compliance costs of doing so, while maintaining equity between taxpayers and protecting the integrity of the tax system. Against this background, the likelihood of deductions being obtained for private expenditure is greatest in situations where:

- the person incurring the farmhouse expenditure lives in the farmhouse; and
- the value of the farmhouse represents a significant proportion of the overall value of the farm.

93. As a result, a practical approach to apportionment has been developed to mitigate compliance costs for farms with a low private-use element. The practical approach has regard to the law and the Commissioner's powers under s 6 and 6A of the Tax Administration Act 1994. This new approach is based on a distinction between:

- farming businesses where the value of the farmhouse (including curtilage and improvements) is 20% or less of the total value of the farm (Type 1 farms); and
- farming businesses where the value of the farmhouse (including curtilage and improvements) is more than 20% of the total value of the farm (Type 2 farms).

94. The respective values of the farmhouse and farm may be used to determine whether the farm is a Type 1 or Type 2 farm. Generally, the value of the farm will include assets attached to the land such as farm buildings, orchards, kiwifruit vines, grape vines and shelterbelts. The valuation of the land does not normally include stock and crops. Nor does it include items of specialised plant not attached to the land. The value of the farm includes all blocks of land (even if they are on different titles) farmed together as part of the same farming enterprise.

95. The Commissioner will accept a reasonable estimate of the values of the farmhouse and farm. In some instances the rateable value will be a reasonable estimate of the value. However, the usefulness of rateable value depends on the circumstances. For instance, although the value of the land plus capital improvements in a rates notice may be a reasonable approximation of the farm's value, the value of the farmhouse may not be as readily ascertainable. This will be the case where the rates assessment only provides a single figure for "improvements" and it is not possible to separate the value of the farmhouse from other improvements such as farm structures, vines, fencing and so on.

96. Alternatively, a bank's valuation for lending purposes or an estate agent's appraisal may also provide a reasonable estimate. However, in some cases a formal valuation will be appropriate, particularly in circumstances where a farm is close to the Type1/Type 2 threshold and they seek to be a Type 1 Farm.

97. As an alternative to value, the Commissioner will allow farmers to use the respective costs of the farm and farmhouse to reflect the relative values of the farm and farmhouse at a particular point in time. Allowing farmers to use cost is intended to reduce compliance costs by avoiding the need for a formal valuation. In order to be used in the threshold calculation, the relative costs need to be comparable and contemporaneous (eg, the cost of a farm in 1990 and the cost of a new farmhouse in 2010 are not comparable or contemporaneous).

98. The term "curtilage" refers to the land surrounding the farmhouse that is used primarily for private purposes. The curtilage may be fenced (like a backyard) or not. If the curtilage is not fenced, the Commissioner will accept a reasonable estimate of the curtilage and its value. The curtilage must be taken into account when determining the value of the farmhouse as a proportion of the overall value of the farm. This is because the curtilage is generally used for private purposes and is not used in the farming business. The extent of the curtilage, and its value, must be measured on a fair and reasonable basis. The Commissioner will accept a valuation, a reasonable estimate of the value of the curtilage, or an apportionment based on land area (ie, on a value/cost per hectare basis). Any apportionment needs to be calculated on a reasonable basis and recognise the land value of the curtilage will often be proportionately higher than the rest of the farm.

99. The Type 1/Type 2 threshold calculation generally only needs to be done once, unless circumstances change. Examples of where the calculation needs to be done again are where a Type 1 farmhouse is extended or has private-use improvements added or where a Type 2 farmer purchases an additional farming block that is farmed together (with the existing farm) as part of the same farming enterprise. The farmer only needs to do the calculation in order to show they are a Type 1 farmer or that they remain so after a change in circumstances. Generally, changes due to market fluctuations and changes that merely confirm the current position (ie, a Type 2 farmer builds an extension on their farmhouse) will not require a further calculation.

100. The next step is to apportion expenses between the business and private use of the farmhouse. For farmers operating Type 1 farms, the Commissioner will accept that 20% of the farmhouse is used for business purposes. However, Type 1 farmers are entitled to do an actual use calculation if they consider that the business use of the farmhouse is greater than 20%. The appropriate methods of apportionment are discussed at paragraph [61] onwards.

101. Farmers operating Type 1 farms may continue to claim a deduction of 100% for interest relating to the farmhouse. (This is the same as the treatment for interest for full-time farmers under the old policies.) This is a practical approach recognising the complexity of financing arrangements for larger enterprises, difficulties with tracing how funds are applied and the potential compliance costs involved.

102. Farmers operating Type 1 farms can also continue to claim a deduction of 100% for rates. The Commissioner understands that the majority of charges for Type 1 farms relate to the farming business (eg, bio-security, flood protection, rural roading

charges). Further, rates assessments often do not distinguish the farmhouse from other improvements; this requires apportionment across all improvements. Also the charges themselves are often a uniform annual general charge levied against land generally and it is not possible to identify business and domestic charges. Allowing a 100% deduction is a practical approach that recognises compliance costs for Type 1 farmers outweigh any tax advantage.

103. For farmers operating Type 2 farms, there is no minimum percentage of the farmhouse that the Commissioner will accept as being for business purposes. Farmers operating Type 2 farms may only claim deductions for expenses, including interest, relating to the actual business use of the farmhouse.

104. For expenses that relate to the farm and the farmhouse (that cannot be dissected), the Commissioner will accept an apportionment of these expenses based on the values of the farm and the farmhouse (including the curtilage and any improvements made to the farmhouse).

105. When apportioning expenses between the business and private use of the farmhouse, Type 2 farmers must undertake a "home office" calculation like any other taxpayer who carries on their business from home. This calculation must be based on the actual use of the farmhouse (for example, on a time and space basis), regardless of whether there is a dedicated home office or different parts of the house are used in the business.

106. The "home office" calculation will, in most cases, only need to be done once (unless the business use of the farmhouse changes). Once calculated, the "home office" percentage can be applied to all general farmhouse expenses that cannot be dissected.

107. Section 71 of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 has inserted a new s DB 18AA in the Income Tax Act 2007. This provides another option for calculating business use of a building that is used partly for business purposes and partly for other purposes. This calculation is well suited to situations where there is a dedicated home office.

108. The old policies distinguished between full-time and part-time farmers. As noted above, the fact that a farmer works part time on the farm is not relevant to applying the general permission.

Telephone rental and fixed line charges

109. This Interpretation Statement replaces and updates the old policy allowing farmers who operate their business from home a 100% deduction for home telephone rental. Farmers should follow the existing practice of other home based businesses. The starting point is that farmers may now claim 50% of their telephone rental charges. Farmers can still claim a higher deduction if they can show that the actual business use of the telephone is greater than 50%. There may be situations where farmers use a home telephone solely for business purposes and a 100% deduction is still justified.

110. If the farmhouse has two telephone lines, one charged at a domestic rate and the other at a commercial rate, 100% of the commercial rental is an allowable deduction. In this case, no part of the domestic rental is deductible.

Summary

111. The following table summarises the practical approach outlined above.

Farm type	Interest and rates charges	General farmhouse expenses	Fixed line telephone charges
Type 1 farms	100% deduction for rates and interest expenses relating to the farm, including the farmhouse.	Dissection where possible, then 20% deduction unless the taxpayer can substantiate a higher deduction.	50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.
Type 2 farms	Dissection where possible, then apportion between farm and farmhouse on a fair and reasonable basis. Deduct amounts attributable to actual business use of the farmhouse.		50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.

Employees and shareholder-employees

112. Sometimes an employee will live in a farmhouse and incur expenses on that farmhouse for the farm business. For example, an employee might use a room in the farmhouse as an office for farm business and pay for the farmhouse utilities (eg, power, telephone or water).

113. Even if an expense incurred by the employee satisfies the general permission, employees are prevented by the employment limitation from claiming any deductions for farmhouse expenses that they incur. However, an employer could reimburse an employee for expenses they incur in connection with their employment. An example might be the portion of a

power bill that relates to a home office. Such reimbursement payments are exempt income to the employee when the requirements of s CW 17(2) are met (and are deductible to the employer – see [55] above).

Shareholders, beneficiaries of trusts and other natural persons not involved in the farming business

114. A company or trustees of a trust may operate the farming business and own the farmhouse. In these situations, a shareholder of the company or a beneficiary of the trust (not being employees) may live in the farmhouse and incur expenses on that farmhouse.

115. The shareholder and the beneficiary are not involved in carrying on the business (ie, they are not employees). As a result, the expenses they incur on the farmhouse have no nexus with deriving income. Therefore, the shareholder and beneficiary cannot claim deductions for expenses they incur on the farmhouse.

Farmhouse expenses incurred by a person not living in the farmhouse

116. Sometimes a person will incur farmhouse expenses, but may not live in that house. Such persons could include a sole trader, partner in a partnership, trustee or company. The person incurring the expenses might rent out the farmhouse, or they might provide the farmhouse as accommodation to another person (under a trust deed, as part of an employment agreement or for some other purpose). The person incurring the expenses might own the farm and lease it out, lease the farm and operate it, or own and operate the farm. An example might be where a sole trader, who owns and operates a farm, provides a second farmhouse as accommodation to their employees.

117. The following scenarios are considered in this part of the analysis:

- an employer incurs farmhouse expenses;
- a lessor incurs farmhouse expenses;
- a person incurs farmhouse expenses where they provide the farmhouse in other circumstances (eg, to a person who is neither an employee nor a lessee).

Employer incurs farmhouse expenses

118. An employer can be any entity: sole trader, partnership, trustee or company. The employer may provide the farmhouse to one or more employees. An example might be where a partnership leases a farm from a company, carries on a farming business, and provides accommodation to an employee in a farmhouse.

119. Where the occupants of a farmhouse are employees, any farmhouse expenses incurred by the employer on that farmhouse will generally be deductible. This is because expenses incurred on employees are an ordinary incident of carrying on a business and will generally have the requisite nexus with deriving business income (unless the capital limitation applies).

120. It should be noted that where expenses incurred on employees relate to a private benefit enjoyed by those employees, other regimes in the Act may also apply. Some examples include the provisions on employee remuneration under s CE 1 (eg, expenditure on account or any other benefit in money, such as reimbursement of a non-business expense), s CE 1B (accommodation provided by employers), or fringe benefit tax under subpart CX.

Lessor incurs farmhouse expenses

121. A farmhouse might be owned by a natural person in their personal capacity, in partnership with another, or as a trustee. A farmhouse might also be owned by a company. In some situations, the owner may rent out the farmhouse. When the owner rents out the farmhouse, the owner will derive rental income. An example might be where a company owns a farm and leases it to partners in a partnership that carry on the farming business and live in the farmhouse.

122. If an expense incurred by the owner on the farmhouse has the requisite nexus with the income-earning process of deriving rental income, then that expense will be deductible under the general permission. The owner will not have to apportion the expense for any private use.

Farmhouse provided in other circumstances

123. A farmhouse might be provided to a person who is neither an employee nor a lessee. This situation will usually arise where the occupant is a relative, beneficiary, shareholder or associated person. An example might be where a trustee, who owns and operates a farm, allows beneficiaries (who are not employees or otherwise involved in the farming business) to reside in a farmhouse in accordance with the trust deed. For example, such beneficiaries might be the former owners of the farm, now retired.

124. For most entities, expenses incurred by the owner, where the occupant is not an employee or lessee, will not satisfy the general permission. This is because there is no income (because the occupant is not paying rent) and the provision of the

farmhouse to such a person has no connection with the farming business. In this situation the expenses will not satisfy the nexus test in the general permission.

125. However, where a company allows a shareholder, or a person associated with a shareholder, to occupy the farmhouse because of the shareholding, a dividend arises under s CD 6. In this situation, the dividend is not deductible. However, the dividend will be assessable to the recipient.

Summary

126. The following table summarises the deductibility of farmhouse expenses in a number of different situations. The table does not include reimbursement payments made by a farming entity to the occupiers of the farmhouse for purely business related expenditure. This will usually be deductible.

Entity/structure	Interest	Other expenses
Partnership or sole trader owns/leases and operates farm	**Sole trader or partner lives in the farmhouse** Apportionment is required. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method (see table at [111]). For Type 1 100% deductible.	**Sole trader or partner lives in the farmhouse** Apportionment is required. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method (see table at [111]).
	Farmhouse provided to employee 100% deductible.	**Farmhouse provided to employee** 100% deductible.
	Farmhouse rented at market value 100% deductible.	**Farmhouse rented at market value** 100% deductible.
	Farmhouse provided for no consideration to someone who is not an employee No expenses are deductible.	**Farmhouse provided for no consideration to someone who is not an employee** No expenses are deductible.
Company owns and operates farm	100% deductible where requirements of s DB 7 met.	**Farmhouse provided to employee** 100% deductible.
		Farmhouse provided to shareholder (not an employee) Not deductible as a dividend.
		Farmhouse rented at market value 100% deductible.
		Farmhouse provided for no consideration to someone who is not a shareholder or employee No expenses are deductible.
Trust owns and operates farm (trading trust)	**Farmhouse provided to employee** 100% deductible.	**Farmhouse provided to employee** 100% deductible.
	Farmhouse rented at market value 100% deductible.	**Farmhouse rented at market value** 100% deductible.
	Farmhouse provided to beneficiary who is not an employee No expenses are deductible.	**Farmhouse provided to beneficiary who is not an employee** No expenses are deductible.
Sole trader, partnership, company or trust owns farm, and farmhouse is leased to another entity at market value	100% deductible for the lessor.	100% deductible for the lessor. Lessee (natural person carrying on the farming business) must apportion rent and other expenses. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method.

Application date of this Interpretation Statement

127. This Interpretation Statement will apply from the start of a taxpayer's 2017-18 income year.

Examples

128. The following examples are included to assist in explaining the application of the apportionment principles and the practical approach outlined in this Interpretation Statement. Please note that the figures used in the examples illustrate the principles explained in this Interpretation Statement and do not take GST into account.

Example 1 – establishing whether farm is Type 1 or Type 2

129. Hayden is a sole trader who owns and operates a dairy farm. Hayden purchased the farm in the 1980s for $490,000. Hayden also purchased a run off block in 2001 for $30,000. Hayden demolished and replaced the original farmhouse with a new build in late 2016 in which he and his family live. The new farmhouse cost $460,000. Hayden wants to know how to work out whether he is a Type 1 or Type 2 farmer.

130. The respective values of the farm and farmhouse should be used to work out whether the farm is a Type 1 or Type 2 farm. Hayden has the option of using cost but in this case the cost is unhelpful as he would be comparing the historic cost of the farm with the recent cost of the new build farmhouse.

131. The $460,000 cost of the new farmhouse can be used as an approximation of the current market value. The farm's updated 2017 rates bill has the rateable value of the whole farm as $4,300,000. Hayden considers that is a reasonable approximation of the market value and decides to use this figure for the threshold calculation. Although the rates bill is for 2017, the two values are sufficiently contemporaneous to use in the threshold calculation.

132. The run off block is on a separate title. However, as it is farmed together as part of the same farming enterprise it can be taken into account when calculating the farm's value. The 2017 rateable value for the run off block is $45,000. The value of the farmhouse is $460,000 and the rateable value of the farm (including run off block) is $4,345,000. The farmhouse is therefore 10.6% of the value of the farm. Even allowing for the value of the curtilage, Hayden is a Type 1 farmer.

Example 2 – Type 1/Type 2 distinction

133. Gerri and Warren own and operate a small kiwifruit orchard in Te Puke. They purchased the farmhouse in 2005 for $275,000 along with a 2 hectare block of green kiwifruit vines for $280,000. They are Type 2 farmers.

134. In mid-2017, they decide to increase their farming operation. They purchase a nearby 2 hectare production block of gold kiwifruit vines and farm the two blocks together as part of the same farming enterprise. Gold kiwifruit vines are worth considerably more than green kiwifruit vines and they pay $1,400,000 for the 2 hectares.

135. Gerri and Warren want to do a further threshold calculation to see if they are now Type 1 farmers. They could use the cost of the farm and farmhouse as an estimate of their respective values, but given the passage of 12 years, fluctuations in the value of kiwifruit vines and the fact they are close to the threshold they prefer to use current values. Unfortunately for Gerri and Warren, the rates notice for the farm is no use in establishing the value of the farmhouse as it merely includes a single figure for "improvements" and they cannot work out how much relates to the farmhouse.

136. Gerri and Warren decide to get a formal valuation. The farmhouse (including the curtilage) is valued at $420,000 and the green kiwifruit block at $445,000. The recent purchase price of $1,400,000 for the 2 hectares of gold kiwifruit is a reasonable approximation of market value for that block. The value of the farmhouse is 18.7% of the total cost of the farm. They are Type 1 farmers.

137. Soon after the farm's expansion the global price of green kiwifruit falls because of bumper crop production in Europe and China. Gerri and Warren decide to gradually replace the green kiwifruit vines with the gold variety. Any decline in value of the green kiwifruit vines (and the farm) because of the global glut is not a change in circumstances requiring a further calculation because the decline in value is temporary in nature. Nor is replacing the vines with the more lucrative gold kiwifruit vines a change in circumstances requiring a further calculation because it merely confirms that Gerri and Warren are Type 1 farmers.

Example 3 – Deductions for Type 1 farms

138. Carolyn is a sole trader who owns and operates a dairy farm in Taranaki. Carolyn does not really know how much of the farmhouse is used for business purposes. Carolyn wants to know what proportion of the farmhouse expenses she can claim as a deduction.

Type 1 or Type 2 farm?

139. First it is necessary to determine whether Carolyn operates a Type 1 or Type 2 farm. Carolyn has a modest house on a reasonable sized farm. In determining the values of the farm and farmhouse, Carolyn considers that the original cost of the farm should reasonably reflect the relative values. The cost of Carolyn's farm was $2.5 million and the cost of the farmhouse (including the curtilage) was $235,000. The farmhouse therefore represents 9.4% of the value of the farm. Therefore, Carolyn operates a Type 1 farm.

Farmhouse expenses

140. For expenses that relate to the farmhouse, based on the policy outlined in this Interpretation Statement, Carolyn can claim a deduction of 20% of expenses to reflect the use of the farmhouse for the farming business. She does not need to provide evidence of the business use of the farmhouse. For instance, the power bill is for electricity used by the farmhouse only. Therefore Carolyn can claim a deduction of 20% of the power bill.

141. For expenses that relate to the whole farm or are calculated with reference to the value of the farm and cannot be dissected (eg, an insurance policy that covers the entire farm), an area apportionment will often give an unrealistically low proportion relating to the farmhouse. One way of working out a realistic proportion is to calculate the value of the farmhouse as a proportion of the total value of the farm and add back any business use of the farmhouse. The value of the farmhouse is 9.4% of the total value of the farm. The business use of the farmhouse is treated as being 20%. Carolyn can therefore claim 20% of the 9.4% proportion of the amount that relates to the farmhouse. This is in addition to the amount that relates to the farm business.

Interest and rates

142. Interest and rates are 100% deductible for Type 1 farmers.

Example 4 – Type 1 farm where the business use of the farmhouse is more than 20%

143. Assume the same facts as Example 3 except Carolyn calculates that she uses more than 20% of the farmhouse for business purposes. Carolyn uses the kitchen, dining room, and laundry for farm business. Carolyn calculates, on a time and space basis, that 25% of the farmhouse is used for business purposes.

144. For expenses relating only to the farmhouse (such as the power bill), the proportion of business use of the farmhouse is 25%. Carolyn can therefore claim a deduction of 25% of the power bill to reflect the actual use of the farmhouse for the farming business.

145. Carolyn still claims 100% of the interest and rates charges that relate to the farm business and farmhouse.

Example 5 – Type 2 farm with a home office

146. Anahera owns and operates a small sheep and goat farm that produces speciality cheeses that are sold at the local farmers' market. Anahera lives in the farmhouse and uses a room in the house as an office for the farm business. Anahera wants to know if she can claim any deductions for the mortgage interest she pays for her farm and farmhouse.

147. Anahera uses the cost of the whole farm and the cost of the farmhouse (including the curtilage) as a way of establishing their relative values. The purchase price of the farmhouse was $200,000. Shortly after the purchase Anahera also made improvements to the farmhouse that cost $100,000 in total. As a result, the total cost of the farmhouse is $300,000. The total cost of Anahera's farm was $700,000 (this includes the improvements made to the farmhouse). The value of the farmhouse is therefore 42.9% of the total value of the farm. Anahera therefore operates a Type 2 farm and must determine the deductibility of any farmhouse expenses under the general rules.

148. The value of the farmhouse is 42.9% of the total value of the farm. Anahera calculates her home office as being 9% of the area of the farmhouse. Therefore, Anahera can claim 9% of 42.9% of the mortgage interest. This is in addition to the mortgage interest that relates to the farm business.

149. The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 has inserted a new s DB 18AA in the Income Tax Act 2007 which provides another option for calculating home office deductions. From the 2017-18 income year, Anahera could choose to use this method which provides a deduction for mortgage interest, rates and rent based on the proportion of floor area used primarily in the business. An allowance for other expenses is calculated on a per-square metre basis at a rate set by the Commissioner.

Example 6 – Type 2 farm without a dedicated home office

150. Anaru owns and operates a small free-range chicken farm in partnership with his wife, Angela. Anaru and Angela live in the farmhouse. The recent cost of the farmland was $1.5 million of which the cost of the farmhouse was $330,000. The value of the farmhouse (including the curtilage) is 22% of the total value of the farm. The partnership therefore falls into the Type 2 farm category and must apportion any farmhouse expenses based on the actual use of the farmhouse.

151. The farmhouse does not have a home office. Instead, Anaru and Angela hold business meetings at the kitchen table and manage the farm accounts from the family computer in the dining room. In addition, Angela sometimes prepares lunches for business visitors in the farmhouse kitchen. Anaru is aware that the partnership can claim deductions for the business proportion of expenses relating to the farmhouse. Anaru wants to know what the partnership can take into account when calculating the business proportion of those expenses. In particular, Anaru wants to know how much of the telephone bill, mortgage interest and rates the partnership can claim as a deduction.

152. The partnership's telephone bill lists the toll calls made each month. Anaru and Angela can only claim a deduction for the calls made for business purposes. For the fixed telephone charges, Anaru and Angela can claim 50% of the fixed telephone charges unless they can show that the actual business use of the telephone is greater than 50%.

153. The floor area of Anaru and Angela's house is 150m². Together, the dining room and kitchen make up 40m² in total, or 27% of the floor area of the farmhouse. Anaru calculates, on a fair and reasonable basis, that these rooms are used for the farm business for 20% of the time. This means that the business use of the farmhouse is 5.4%.

154. For the expenses that relate to the whole farm, including the farmhouse (ie, mortgage interest and rates), Anaru should also calculate the value of the farmhouse as a proportion of the total value of the farm and add back any business use of the farmhouse.

155. The value of the farmhouse is 22% of the total value of the farm. The farmhouse is used 5.4% for business purposes. Anaru can therefore claim 5.4% of 22% of the mortgage interest. This is in addition to 78% of the mortgage interest that relates to the farm business. The rates bill for the farmhouse includes charges for certain services that are charged per house. The starting point is that those service charges should be dissected and are not deductible because they relate to the private use of the farmhouse. Conversely, any service charges (such as bio-security) that relate to the business use of the farm should also be dissected and can be deducted.

156. Rates charges that relate to the whole farm or are calculated with reference to the value of the farm (ie, the general and fixed charges on the rates bill) can be calculated in the same way as mortgage interest. The value of the farmhouse is 22% of the total value of the farm. This means that 78% of the rates charges relating to the whole farm will be deductible. Additionally, the farmhouse is used 5.4% for business purposes. Anaru can therefore also claim 5.4% of 22% of the rates charges that relate to the whole farm.

Example 7 – Farmer works part-time

157. Gus owns and operates a small alpaca farming business and also works in the city four days a week. Gus' farm is a Type 2 farm. Gus wants to know if he can claim deductions on any expenses for the home office in his farmhouse. The home office is where Gus does all the administration for his farm. Gus also wants to know if he can claim deductions for expenses relating to the spa pool and leather lounge suite in the farmhouse as these are sometimes used when business associates visit the farm.

158. Gus can claim deductions for the expenses that relate to the home office. Gus could use a similar calculation as Anaru in Example 6 to determine the proportion of private and business use of the farmhouse and farm. The fact that Gus does not work full-time on the farm does not affect the deductibility of the expenses for the use of the farmhouse in the farming business. Alternatively, from the 2017-18 income year, Gus could use the method set out in s DB 18AA of the Act.

159. The spa pool and leather lounge suite are essentially private in nature and not used as part of the farming business. Therefore, Gus cannot claim any deductions for these items.

Example 8 – Farm employees live in separate farmhouse

160. Reggie owns and operates a large deer farm and lives in the main farmhouse. Reggie's farm also has another house situated on it. Three of Reggie's employees live in that farmhouse. Reggie wants to know what expenses are deductible for the employee farmhouse.

161. Provided that none of the general limitations apply, all of the expenses incurred by Reggie on the employee farmhouse on the farm are deductible. This is because expenses incurred on employees are an ordinary incident of carrying on a business. Such expenses satisfy the nexus test in the general permission. As noted at [54], the value of this accommodation

provided by Reggie is income to his employees. In addition, to the extent that Reggie also provides fringe benefits to these employees so that a liability for fringe benefit tax arises, the FBT will also be deductible. Fringe benefits provided to employees are discussed at [57] and [58].

Example 9 – Farmer leases farm from family trust

162. Tane is a sole trader who operates a dairy farm in the Waikato. Tane runs the farm from an office in the farmhouse that is dedicated to the farming business. Tane leases the farm and the farmhouse from his family trust and is obliged under the rental agreement to pay rates, insurance and other farmhouse expenses. Tane wants to know if he can claim deductions for these expenses and the rent payments made to the family trust.

163. The total cost of Tane's farm to the Trust was $5 million and the cost of the farmhouse (including curtilage) was $450,000. These costs reflect the relative values of the farm and farmhouse. The value of the farmhouse is therefore 9% of the total value of the farm. Tane therefore operates a Type 1 farm.

164. The principles outlined in this Interpretation Statement apply equally to this situation. The Trust can claim deductions for expenses in line with the table at [126]. Tane may claim deductions for his expenses to the extent that they have the requisite nexus with the farming business.

Farmhouse expenses

165. Based on the policy outlined in this Interpretation Statement, Tane can claim a deduction of 20% of the farmhouse expenses (such as the power bill) to reflect the use of the farmhouse for the farming business. However, Tane can claim more if he can show that the business use of the farmhouse is greater than 20%.

Farm/Farmhouse expenses

166. For expenses that relate to the whole farm (ie, rent payments and insurance premiums that cannot be dissected) or are calculated with reference to the value of the farm, an area apportionment will often give an unrealistically low proportion relating to the farmhouse. One way of working out a realistic proportion is to calculate the value of the farmhouse as a proportion of the total value the farm and add back any business use of the farmhouse.

167. The value of the farmhouse is 9% of the total value of the farm. The business use of the farmhouse is treated as being 20%. Tane can therefore claim 20% of the 9% of the rent payments and insurance premiums. This is in addition to the expenses that relate to the farm business.

168. As the farm is a Type 1 farm, Tane is also permitted to deduct 100% of the rates charges.

References

Related rulings/statements

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'Farmers leasing Farm from Trust – Rental Portion Applicable to Dwellings', *Public Information Bulletin* No 89 (January 1977): 4

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'Telephone rental deductions for businesses based at home', *Tax Information Bulletin* Vol 5, No 12 (May 1994): 2

Subject references

Deductions
Employment limitation
Farming
General permission
Private limitation

Legislative references

Income Tax Act 2007, ss CD 6, CD 20, CE 1, CE 1B CE 5, CW 17, CX 2, CX 37, DA 1, DA 2, DA 3, DB 6, DB 7.

Case references

Buckley & Young Limited v CIR (1978) 3 NZTC 61,271 (CA)
Case E11 (1981) 5 NZTC 59,064
Case F47 (1983) 6 NZTC 59,801
Case G13 (1985) 7 NZTC 1,048
Case H12 (1986) 8 NZTC 168
Case J33 (1987) 9 NZTC 1,190
Case K57 (1988) 10 NZTC 465
Case L81 (1989) 11 NZTC 1,468
Case N35 (1991) 13 NZTC 3,308
Christchurch Press Company Ltd v CIR (1993) 15 NZTC 10,206 (HC)
CIR v Banks (1978) 3 NZTC 61,236 (CA)
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Eggers v CIR (1988) 10 NZTC 5,153 (CA)
Hunter v CIR (1989) 11 NZTC 6,242 (HC)
Pacific Rendezvous Limited v CIR (1986) 8 NZTC 5,146 (CA)
Ronpibon Tin NL v FCT (1949) 78 CLR 47 (HCA)

Appendix – Legislation

Income Tax Act 2007

1. Section DA 1 relevantly provides:

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**.

2. Section DA 2 provides:

DA 2 General limitations

Capital limitation

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

Private limitation

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

Exempt income limitation

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

Employment limitation

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

Withholding tax limitation

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

Non-residents' foreign-sourced income limitation

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

Relationship of general limitations to general permission

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

3. Sections DB 6 and 7 provide:

DB 6 Interest: not capital expenditure

Deduction

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

Exclusion

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

Conduit financing arrangements [Repealed]

(3) [Repealed]

Link with subpart DA

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

DB 7 Interest: most companies need no nexus with income

Deduction

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

Exclusion: qualifying company

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

Exclusion: exempt income

(3) If a company (**company A**) derives exempt income or another company (**company B**) that is part of the same wholly-owned group of companies derives exempt income, subsection (1) applies to company A only if all the exempt income is 1 or more of the following:

(a) dividends; or

(b) income exempted under section CW 58 (Disposal of companies' own shares); or

(c) income exempted under section CW 60 (Stake money) and ancillary to the company's business of breeding.

Exclusion: non-resident company

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

Exclusion: interest related to tax

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

Consolidated groups

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

Relationship with subpart DG

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

Conduit financing arrangements [Repealed]

(7) [Repealed]

Link with subpart DA

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

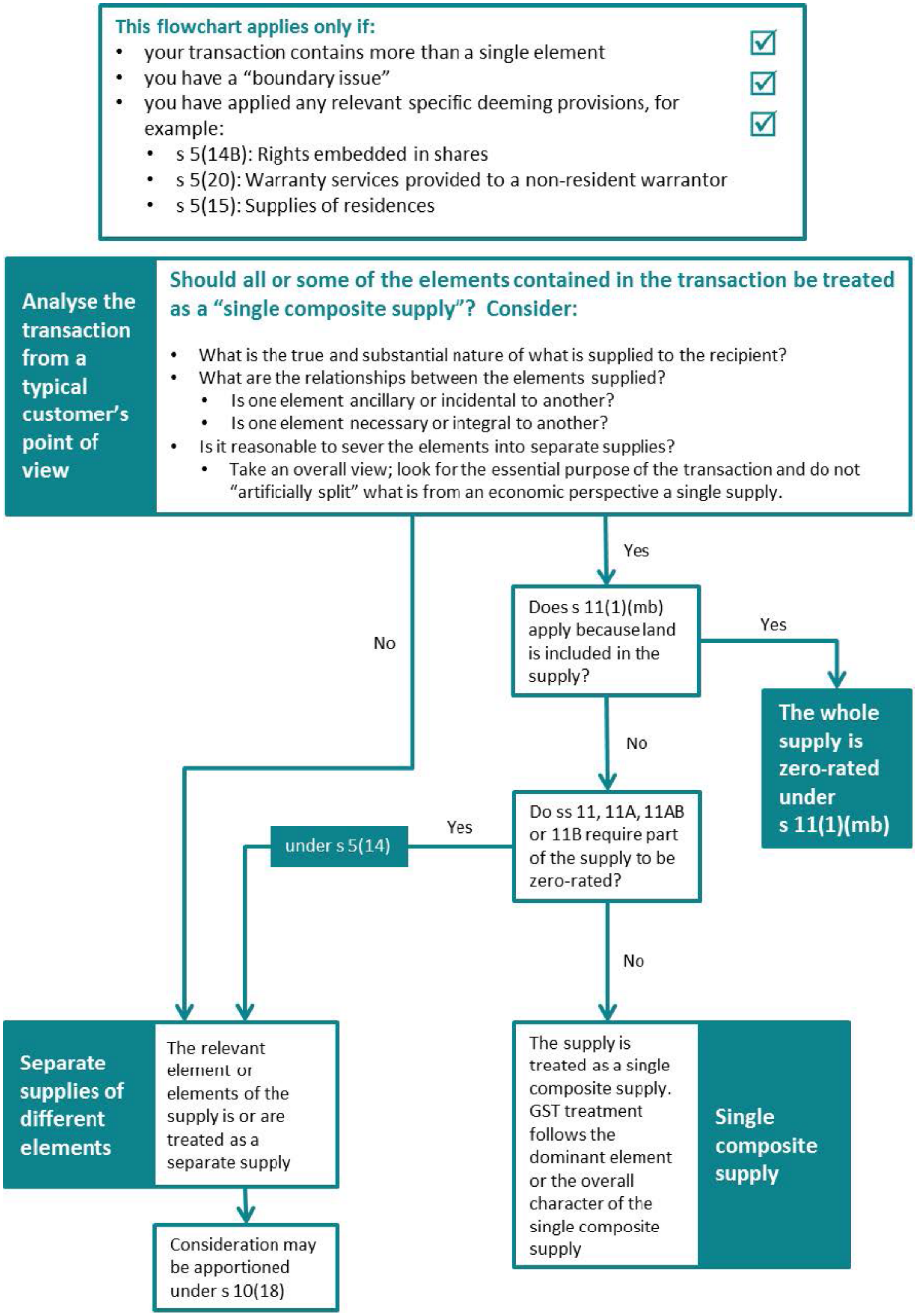
IS 17/03: Goods and services tax – single supply or multiple supplies

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Summary

1. A registered person who enters into a contract with a recipient to supply several goods and services needs to determine what sort of supply or supplies they have made so they can correctly account for GST. Where multiple elements are supplied with potentially different GST treatments, the supplier must determine whether they have made a single composite supply (of all the elements) with a single GST treatment, or multiple separate supplies (of each element or a combination of elements) with different GST treatments.
2. In some cases, it may be clear from the contract that only a single element is supplied to the recipient. Boundary issues do not arise on the supply of a single element.
3. Boundary issues may arise where multiple elements are supplied together. Boundary issues arise where some elements of the supply are subject to GST at the standard rate and other elements are zero-rated, exempt or not subject to GST at all. If the GST treatment of each element of the supply is the same then boundary issues do not arise.
4. Sometimes the Act deems supplies of multiple elements to be treated in a particular manner (for example, ss 5(20B), 5(20) and 5(15)). Where the Act does not deem a particular outcome, the arrangement actually entered into and carried out between the supplier and recipient must be carefully considered. The answers to the following questions may help a registered person to decide whether they have made one composite supply or multiple separate supplies:
   - What is the true and substantial nature of what is supplied to the recipient for their payment?
   - What are the relationships between the elements supplied?
   - Is it reasonable to sever the elements into separate supplies?
5. The first question requires a registered person to identify the true and substantial nature of what is supplied to the recipient. This is determined objectively and examines what is supplied ***from the recipient's perspective***.
6. The fact elements supplied to the recipient could have been supplied separately does not mean those elements should be severed from the rest of the supply. In addition, the fact a single price is charged to the recipient does not determine whether one or more than one supply is made. It is the actual supply made to the recipient that must be considered and not how the supply is invoiced or charged to the recipient.
7. In considering the second question, namely the relationships between the different elements supplied, the courts consider whether one element is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. The phrases "ancillary or incidental to" and "necessary or integral part of" are different descriptions of a similar test. The facts of each case will determine which description is more appropriate. Factors that indicate that elements are ancillary or incidental to, or a necessary or integral part of, a dominant element include whether the element is:
   - not an aim in itself; instead, the element facilitates, contributes to, or enables the supply of the dominant element;
   - a means of better enjoying the dominant element;
   - an optional extra and is not in any real or substantial sense part of the consideration for which a payment is made.
8. The third question to answer is whether a sufficient distinction exists between the different elements of a transaction to make it reasonable to sever them into separate supplies. This question requires taking an overall view and looking for the essential purpose of the transaction and not artificially splitting what, from an economic point of view, is a single supply. If, on an objective assessment, it is not reasonable to sever the different elements of the transaction, then there will be only one composite supply.
9. If there is one composite supply, the zero-rating provisions may apply to zero-rate part or all of the supply. The compulsory zero-rating of land provisions may mean the supply is zero-rated if it includes land: s 11(1)(mb). Additionally, despite being a single composite supply, part of the supply may be required to be zero-rated: ss 11, 11A, 11AB or 11B. If the zero-rating provisions do not apply, the GST treatment will follow the dominant element of the supply. If there is no dominant element (for example, the supply is made up of several equally important elements that are integral to each other), the GST treatment will be determined by the overall characteristics of the single composite supply.
10. If there are multiple supplies, the relevant provisions of the Act are applied to each supply. Where the recipient pays a global amount for multiple supplies with different GST treatments, the consideration is apportioned under s 10(18) between taxable supplies and non-taxable or exempt supplies.

11. The process is summarised in the following flowchart. The flowchart is intended to be an aid to interpretation only. A more detailed discussion of the process follows the flowchart:



Introduction

12. GST is imposed on the supply of goods and services in the course or furtherance of a taxable activity carried on by a registered person by reference to the value of the supply: s 8(1). Supply is defined broadly to include "all forms of supply": s 5(1). Supplies can be subject to GST at the standard rate, or be zero-rated, exempt or not subject to GST. Issues can arise where different elements of a supply are potentially subject to different GST treatments. These issues are referred to as "boundary issues".

13. Boundary issues arise only where multiple elements are supplied. Contracts for the supply of a single element do not raise boundary issues. Boundary issues primarily arise where some elements of the supply are subject to GST at the standard rate and other elements are zero-rated, exempt or not subject to GST. If the GST treatment of each element of the supply is the same, then boundary issues do not arise. Unlike other jurisdictions, New Zealand has relatively few boundary issues.

14. Where multiple elements are supplied with potentially different GST treatments, the supplier must determine whether they have made a single composite supply with a single GST treatment or multiple separate supplies with different GST treatments.

15. The single composite supply or multiple separate supplies issue arises in various scenarios. For example:
    - language schools – whether the supply of language tuition (standard-rated) is a separate supply from pre-arrival assistance services (zero-rated), which was considered in *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (HC) and is discussed from [41];
    - credit card surcharges – whether the charge for paying by credit card (exempt) can be separated from the goods or services being paid for (standard-rated); and
    - loyalty cards – whether the supply of loyalty points (standard-rated) is a separate supply from the supply of credit card services (exempt).

16. The Commissioner considered specific single composite supply or multiple separate supplies issues in the following items:
    - "Financial Planning Fees – GST Treatment" *Tax Information Bulletin* Vol 13, No 7 (July 2001): 37 (IS0079). This statement addresses the GST treatment of financial planning fees charged to investors where the supply comprised exempt financial services and associated potentially standard-rated services.
    - "QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65.
    - "Goods and Services Tax – GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02). This statement addresses the GST treatment of taxable supplies of care services and accommodation in a commercial dwelling, and exempt supplies of financial services and accommodation in a non-commercial dwelling.

17. The purpose of this Interpretation Statement is to set out the general principles for determining whether a supply of multiple elements (supplied together in a single transaction) is a single composite supply or multiple separate supplies and to apply those principles to examples. The Commissioner considers that these general principles are consistent with those set out and applied in the items listed at [16].

Analysing supplies involving boundary issues

18. Before reviewing how the courts have analysed boundary issues, it is necessary to consider whether any specific deeming provisions of the Act will apply.

19. The Act contains several provisions that prescribe how supplies must be treated. This means that irrespective of how the supply might be analysed under ordinary principles, the Act overrides this and specifies how the supply will be treated. This occurs, for example, in:
    - s 5(14B) for rights embedded in shares;
    - s 5(20) for warranty services provided to a non-resident warrantor; and
    - s 5(15) for supplies including residences.

20. The application of these sections is discussed briefly in [21] to [28] below. This list is not exhaustive. Other provisions in the Act may have similar effects.

Rights embedded in shares

21. Section 5(14B) was enacted (along with the definition of "associated supply" in s 2 and s 14(1B)) in response to the outcome in *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915 (CA) for supplies of equity securities and participatory securities ("shares"). *Gulf Harbour* is discussed from [30].

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22. Section 5(14B) provides that if part of a supply of a share is the supply of a right to receive supplies of goods and services that are not exempt supplies, the supply of the right is treated as being a separate supply. This may mean the right is subject to GST rather than being an exempt financial service. For more information about s 5(14B), see "Goods and Services Tax – GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02), [142]–[155].
23. If elements other than the shares (part of which is the right to receive non-exempt supplies) are supplied under the contract, those other elements must still be considered to determine whether there is a single composite supply or multiple separate supplies.

Warranty services provided to a non-resident warrantor

24. Section 5(20) applies to the supply of services under a warranty covering imported goods. Commonly, two types of warranty cover imported goods:
    - a factory warranty offered by the non-resident manufacturer to the importer; and
    - an extended warranty offered by the importer or distributor to the final consumer.
25. When the final consumer makes a claim on the warranty, the importer or distributor makes two supplies, namely, a supply of:
    - goods and services to the final consumer; and
    - the service of remedying a defect under a factory warranty to the non-resident warrantor (zero-rated under s 11A(1)(ma)), who pays for the supply of that service.
26. Section 5(20) requires the supply of goods and services to the final consumer to be treated as the service of remedying a defect to the non-resident warrantor. It effectively ignores the supply of goods and services to the final consumer. This makes it more likely that the supply of warranty services by the importer or distributor can be zero-rated as a service supplied to a non-resident. For more information about ss 5(20) and 11A(1)(ma), see "Zero-rating of Warranty payments" *Tax Information Bulletin* Vol 14 No 11 (November 2002): 71.

Supplies including residences

27. Section 5(15) deems a supply that includes a principal place of residence to be a separate supply from the supply of any other real property included in the supply. The section also applies to a dwelling that has been rented out by the vendor exclusively for accommodation for at least the preceding five years. For example, when a farm (which includes the farmer's house and its surrounding curtilage) is sold, s 5(15) provides that the vendor's supply of the farmer's house and curtilage is a separate supply from the supply of the remainder of the farm. The GST treatment of each supply is determined separately. Usually, the supply of the remainder of the farm must be zero-rated under s 11(1)(mb) while the supply of the farmer's house and curtilage is not subject to GST because it is private and does not form part of the vendor's taxable activity.
28. Once s 5(15) has been applied, the remaining elements (other than the principal place of residence or dwelling) supplied under the contract must still be considered to determine whether there is a single composite supply or multiple separate supplies.

Whether the supply should be treated as a single composite supply

29. Once any relevant specific deeming provisions have been considered, the next step is to determine the nature of the supply. The approach of the New Zealand courts to identifying what has been supplied is to consider the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances: *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA); *Gulf Harbour*.
30. In *Gulf Harbour*, the Court of Appeal emphasised the importance of identifying the true nature of the legal arrangements entered into between the supplier and the recipient when determining the GST consequences of a supply. In that case, the taxpayer supplied redeemable preference shares that included membership rights in a golf club (the rights were attached to the shares). The Commissioner argued the supply was of a golf club membership, so was subject to GST. Alternatively, the Commissioner argued that there were two supplies: a supply of a share and a supply of a golf club membership. The taxpayer argued that there was a single supply of a GST-exempt financial service (a share).
31. The Court of Appeal stated that the Commissioner's argument (at [39]) "involves putting the contractual arrangement to one side and looking at what in substance [the suppliers] were supplying …". The Court of Appeal considered the Commissioner was incorrectly looking at what "in substance" was being supplied, instead of looking at the contractual arrangement. The Court considered the "true nature" of a transaction must be ascertained by a careful consideration of the legal arrangements actually entered into and carried out – not by an assessment of the broad substance of the transaction, measured by the results intended and achieved, or of the overall economic consequences.

32. The Court of Appeal held that the golf club membership rights attached to each share were incidents of the share and no independent source or origin of those rights existed. As a result, the Court found for the taxpayer and held that there was a single supply of a share. The Act was subsequently amended in response to this outcome for supplies of equity securities and participatory securities: ss 2 (definition of "associated supply"), 5(14B) and 14(1B).

33. Where it is unclear whether there is one composite supply or multiple separate supplies under the contract, the transaction must be analysed further to determine the issue. Case law has established numerous principles to assist in this enquiry.

34. The leading New Zealand decision considering whether there is a single supply or multiple supplies is the High Court decision in *Auckland Institute*. In *Auckland Institute*, Hansen J considered the GST treatment of supplies to international students studying in New Zealand. The taxpayer provided tuition services to students coming to New Zealand from overseas. An associated company provided pre-arrival services. The students paid a single "global fee" to the taxpayer for all supplies from both the taxpayer and the associated company. One of the issues before the Court was whether it was appropriate to split the supply to enable the pre-arrival services to be zero-rated.

35. Hansen J discussed the approach of the House of Lords in *Card Protection Plan v Customs & Excise Commissioners* [2001] 2 All ER 143. In that case, the House of Lords considered whether a credit card protection plan offered to cardholders was a single composite supply or two independent supplies comprising the supply of VAT-exempt insurance and a separate supply of VAT-chargeable card registration services. The House of Lords concluded the dominant supply was of VAT-exempt insurance and the supply of the card registration services was ancillary to the exempt supply. In *Auckland Institute*, Hansen J summarised the principles from *Card Protection Plan* for determining whether a supply could be separated into multiple supplies (at [32]):

> - Every supply of a service must normally be regarded as distinct and independent.
> - A supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system.
> - The essential features of a transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.
> - There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.
> - Even if a single price is charged which may indicate a single supply, it must still be considered whether the arrangements indicated that the customer intended to purchase two distinct services.

36. After reviewing all the relevant authorities, Hansen J summarised the principles for determining whether a supply could be separated into multiple supplies (with one or more differing GST treatments) (at [36]):

> [a] In determining whether a supply may be apportioned for GST purposes, it is necessary to examine the true and substantial nature of the consideration given to determine whether there is a sufficient distinction between the allegedly different parts to make it reasonable to sever them and apportion them accordingly.
>
> [b] The enquiry is to determine whether one element of the transaction (or consideration given) is a necessary or integral part of another or whether it is merely ancillary to or incidental to that other element.
>
> [c] A service will be ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.

37. Based on these principles, the Commissioner considers it helpful to ask three questions when analysing the transaction:

- What is the true and substantial nature of what is supplied to the recipient?
- What are the relationships between the elements supplied?
- Is it reasonable to sever the elements into separate supplies?

38. When answering these questions, it is important to consider the supply from the perspective of a typical customer.

What is the true and substantial nature of what is supplied to the recipient?

39. The first question requires a registered person to identify the essential features of the arrangement – the true and substantial nature of what is supplied to the recipient for their payment. In doing so, it is important to examine what is supplied from the point of view of a "typical customer": *Card Protection Plan*. In *Auckland Institute*, Hansen J stated:

> [44] In my view, the attempt to characterise all of the services provided by International as a separate supply is based on a fundamental misconception. It overlooks **the need to examine the supply from the point of view of the consumer**. It focuses on the arrangements between AIS and International. **It fails to consider the true and substantial nature of the consideration given to the consumer**.

[45] The importance of examining the services provided under the contract between the supplier and recipient emerges clearly from the decision of the Court of Appeal in *Wilson & Horton Ltd v C of IR* (1995) 17 NZTC 12,325. … Richardson J observed at 12,328 that **the statutory scheme is directed to contractual arrangements between the supplier and the recipient of the supply** … [Emphasis added]

40. The Commissioner considers that the phrase "the true and substantial nature" does not refer to an "in substance" analysis of the arrangement between the supplier and the recipient. Instead, "the true and substantial nature of the consideration given to the consumer" refers to what the recipient paid for and was supplied with. It requires an examination of the supply from the recipient's perspective. The true and substantial nature of what is provided to the recipient (the supply or supplies) is determined objectively: *British Airways plc v Customs & Excise Commissioners* [1990] STC 643 (CA).

41. The relevant arrangement is the one between the supplier and the recipient. It is irrelevant that the supplier may arrange some other party to deliver the goods or services to the recipient on the supplier's behalf. This was the view taken in *Auckland Institute*. In that case, one member of a group of companies contracted with overseas students to provide tuition services. The tuition services were provided to the students by another company in the group. Hansen J concluded that whether a service could be supplied separately (by another entity or a third party) was irrelevant in determining whether a single supply was made. Hansen J focused on the supply actually made under the contract with the recipient – "the true and substantial nature" of what was supplied to the recipient.

42. In this step, the focus is not on what one of the parties subjectively considered the supply was, or could have been. The relevant perspective is to consider what was supplied to the recipient as viewed objectively from the recipient's perspective. The fact a single price is charged to the recipient does not determine whether one or more than one supply is made. It is the actual supply made to the recipient that must be considered and not how the supply is invoiced or charged.

What are the relationships between the elements supplied?

43. It is also helpful to consider the relationships between the different elements supplied. The courts consider whether one element of the transaction is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. The phrases "ancillary or incidental to" and "necessary or integral part of" are different descriptions of a similar test: *C & E Commrs v United Biscuits (UK) Limited* [1992] STC 325 (Ct of Sess). The Court in that case noted that one description might be more appropriate for one set of facts and the other for a different set of facts. This view was echoed in *College of Estate Management v Customs & Excise Commissioners* [2005] UKHL 62, where the Court noted that the applicable test will depend on the facts of the case. If one element of the transaction is ancillary or integral to another (dominant) element of the transaction, then there will be a single composite supply, with the GST treatment of that supply following the dominant element.

44. Examples of elements that are ancillary or incidental to, or a necessary or integral part of, a dominant element include where the element is:

- not an aim in itself; instead the goods or services facilitate, contribute to, or enable the supply of the dominant part;
- a means of better enjoying the dominant supply;
- an optional extra and not in any real or substantial sense part of the consideration for which a payment is made.

45. In *Auckland Institute* Hansen J quoted from *Customs & Excise Commissioners v Wellington Private Hospital Ltd* [1997] STC 445 (EWCA) at 462, where Millett LJ noted that the issue is not whether one element is ancillary or incidental to, or even a necessary or integral part of, the whole, but whether one element is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. Hansen J stated (at [30]):

The issue is not whether one element of a complex commercial transaction is ancillary or incidental to, or even a necessary or integral part of, the whole, **but whether one element of the transaction is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction**. The reason why the former is the wrong question is that it leaves the real issue unresolved; whether there is a single or a multiple supply. **The proper inquiry is whether one element of the transaction is so dominated by another element as to lose any separate identity as a supply for fiscal purposes, leaving the latter, the dominant element of the transaction, as the only supply. If the elements of the transaction are not in this relationship with each other, each remains as a supply in its own right with its own separate fiscal consequences**. [Emphasis added]

46. Hansen J held that the pre-arrival services were ancillary or incidental to the principal supply of tuition services. Therefore, the supply of tuition services and pre-arrival services comprised a single supply of tuition services:

[48] …They are goods and services provided to enable it (or AIS) to better perform the services supplied to students. Students did not contract for the provision of those services. It may be argued that the students benefited from them but, as Richardson J pointed out in *Wilson & Horton*, that is not the test.

…

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[53] Notwithstanding the Commissioner's concession that pre-arrival services constitute a separate supply, I am of the view that **all of the services provided by International/AIS to students overseas are an integral part of the supply of tuition services**. In terms of the fourth of the propositions in the *Card Plan Protection* case, **I would regard those services as not constituting an aim in itself but as a means of better enjoying the principal service**. [Emphasis added]

47. Hansen J concluded (at [52] and [59]) that the pre-arrival services were ancillary and integral to the supply of tuition, because they facilitated the students undertaking a course of study.

48. Hansen J borrowed heavily from the United Kingdom VAT cases when deciding whether the pre-arrival services were ancillary or integral to the supply of tuition. Although the categories of goods and services that are exempt or zero-rated under the United Kingdom VAT legislation differ from those under the New Zealand legislation, Hansen J considered the approaches taken in the United Kingdom VAT cases to be of assistance.

49. In *College of Estate Management*, the College provided a distance-learning course and the necessary written materials to complete the course. The Court considered that the written materials were not ancillary to the provision of the course, but neither was the supply of the written materials an end in itself. Lord Rodger stated:

[10] … But, since the court envisages that the principal supply may itself comprise more than one element, plainly, in cases where there is no ancillary supply, a single supply may still be made up of more than one element. **So where a taxpayer is involved in a transaction in which he performs several services, none of which can be singled out as the dominant or principal supply, it may nevertheless be necessary to consider whether, for tax purposes, they are properly to be regarded as elements of a single supply**. The supply of restaurant services is one example (see *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* C-231/94 [1996] All ER (EC) 656, [1996] ECR I-2395).

[11] … In the present case, however—leaving aside any allocation of a proportion of the price—it would be highly artificial, to say the least, to describe the printed materials as nothing more than a means for the students the better to enjoy the education supplied by the College. In reality, those materials were the means by which the students obtained most of their education.

[12] **But the mere fact that the supply of the printed materials cannot be described as ancillary does not mean that it is to be regarded as a separate supply for tax purposes**. One has still to decide whether, as a matter of statutory interpretation, the College should properly be regarded as making a separate supply of the printed materials or, rather, a single supply of education, of which the provision of the printed materials is merely one element. … **The question is whether, for tax purposes, these are to be treated as separate supplies or merely as elements in some over-arching single supply**. … [Emphasis added]

50. Lord Walker stated:

[30] … **But there are other cases** (including the *Faaborg* case [C-231/94 *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* [1996] STC 774 (ECJ)], the *Dr Beynon* case [*Beynon and Partners v Customs & Excise Commissioners* [2004] UKHL 53] and the present case) **in which it is inappropriate to analyse the transaction in terms of what is 'principal' and 'ancillary',** and it is unhelpful to strain the natural meaning of 'ancillary' in an attempt to do so. Food is not ancillary to restaurant services; it is of central and indispensable importance to them; nevertheless there is a single supply of services (see the *Faaborg* case). Pharmaceuticals are not ancillary to medical care which requires the use of medication; again, they are of central and indispensable importance; nevertheless there is a single supply of services (see the *Dr Beynon* case).

...

[32] … **What the judge called 'a component part of a single supply' may be (in the fullest sense) essential to it—a restaurant with no food is almost a contradiction in terms, and could not supply its customers with anything—and yet the economic reality is that the restaurateur provides a single supply of services**. Without the need to resort to gnomic utterances such as 'the medium is the message', the same sort of relationship exists between the educational services which the College provides to a student who takes one of its distance-learning courses and the written materials which it provides to the student. [Emphasis added]

51. The House of Lords considered that the written materials were the means by which the students obtained most of their education. Their Lordships implied that the written materials were of central and indispensable importance to the educational services. The written materials were necessary to complete the course. The Court concluded that the supply of the written materials was part of the overall supply of education services.

52. College of Estate Management was recently distinguished in *Metropolitan International Schools v Revenue & Customs Commissioners* [2015] UKFTT 517 (TC). In *Metropolitan International* the Court said (at [66]) that "an element that is not an end in itself ranks as an ancillary element. Ancillary elements generally contribute to the better enjoyment of the principal element". On the facts of *Metropolitan International*, from a recipient's point of view, there was a supply of VAT-exempt manuals with a separate supply of optional educational services (which would not lead to any qualification unless the recipient undertook exams with a third party). This can be compared with *College of Estate Management*, where the facts showed that the overall characteristic of the supply was educational services (leading to a formal qualification) with the additional supply of written materials being part of the supply of the educational services.

53. An example of minor or peripheral parts of a composite supply is seen in *Tumble Tots (UK) Ltd v Revenue & Customs Commissioners* [2007] EWHC 103 Ch. In this case, it was held there was a single supply of membership of a club that conferred on a child the right to attendance at classes involving structured physical play. Other benefits received on admission to membership (a DVD, a CD, a gym bag, a membership card, personal accident insurance for a child while attending a class, and a subscription for a magazine) were not separate supplies, but were peripheral, and ancillary, to the supply of membership. Briggs J considered that it was "a matter of common sense" that the fee was for membership of the club and not the other benefits of membership (at [27]). To conclude otherwise "would be to allow the tail to wag the dog" (at [29]).

Is it reasonable to sever the elements into separate supplies?

54. Finally, it is necessary to consider whether it is reasonable to sever the elements of a transaction into separate supplies. This test requires taking an overall view, without over-zealous dissection, and to look for the essential (or dominant) purpose of the transaction: *College of Estate Management* (per Lord Walker); *Card Protection Plan.* A supply that comprises a single service from an economic point of view should not be artificially split: *Card Protection Plan*.

55. Similarly, in *Auckland Institute*, Hansen J cites Tipping J's judgment in *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,140 (HC). In *Smiths City*, Tipping J noted (at 9,144) that the Court "must decide as a matter of fact and degree whether there is in the transaction under scrutiny a sufficient distinction between the allegedly different parts to make it reasonable to sever them and apportion accordingly". If, on an objective examination, it is not reasonable to sever the different elements of the transaction, then there will be one composite supply only.

56. It appears from the cases cited above that the "reasonable" test focuses on the essential purpose of the transaction and on the elements themselves (whether there is a sufficient distinction between the elements to make it reasonable to sever them and apportion accordingly) rather than on whether a separate amount is charged for the element in question or on how easily a global fee can be apportioned.

57. Further, one of the principles from *Card Protection Plan* for determining whether a supply could be separated into multiple supplies (as summarised in *Auckland Institute* (at [32])) is:

> Even if a single price is charged which may indicate a single supply, it must still be considered whether the arrangements indicated that the customer intended to purchase two distinct services.

58. Hansen J also stated in *Auckland Institute* (at [61]):

> **I do not see the fee structure as a decisive consideration** but I think it tends to confirm that the services which the plaintiff claims are covered by the overseas assistance fee are more realistically to be seen as among the costs which AIS incurs in providing tuition services. [Emphasis added]

59. Hansen J's comments relate to an argument by the Commissioner that as there was no material difference between the fees charged to domestic and overseas students, the fee structure confirmed that a separate supply of overseas assistance services was not made to students. Hansen J did not consider that the fee structure was determinative.

60. And in *Customs & Excise Commissioners v British Telecommunications Plc* [1999] BTC 5,273 (which was cited in *Auckland Institute of Studies*) Lord Slynn said:

> **On the authorities it is clear that the fact that one 'package price' is charged without separate charge for individual supplies being specified does not prevent there being two separate supplies for VAT purposes. In my opinion the fact that separate charges are identified in a contract or on an invoice does not on a consideration of all the circumstances necessarily prevent the various supplies from constituting one composite transaction nor does it prevent one supply from being ancillary to another supply which for VAT purposes is the dominant supply**. Even though it may be desirable to approach each supply as if it were a separate supply and even though each supply in a composite transaction may be an independent separate supply the **essential features of a transaction** may show that one supply is ancillary to another and that it is the latter that for VAT purposes is to be treated as the supply. [Emphasis added]

61. Lord Hope (also in *British Telecommunications*) similarly considered that in all cases the essential features of the transaction must be identified. All the circumstances of the transaction must be considered and no one factor will determine whether there is a separate supply. Whether a separate charge is made or whether a separate price can be identified, whether the service could be supplied separately or whether the supplies are "physically and economically dissociable" (for example, where there is a supply of goods and a supply of services and the price for each supply can be identified) are not determinative.

GST treatment of a single composite supply

62. If it is determined that there is a single composite supply, it is still necessary to determine whether there are any other specific provisions in the Act that may apply. For example, the following matters need to be considered.

Some supplies of land must be zero-rated

63. The first is whether the single composite supply includes land and must be zero-rated. Section 11(1)(mb) provides that a supply that wholly or partly consists of land must be zero-rated if at settlement date:
    - the supply is made by a vendor who is a registered person to a purchaser who is a registered person;
    - the purchaser acquires the goods (including land) supplied with the intention of using them for making taxable supplies; and
    - the land included in the supply is **not** intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative of the purchaser.
64. If s 11(1)(mb) applies, the single composite supply must be zero–rated, regardless of whether the land is the dominant element of the supply.

Other supplies may be partly zero-rated

65. Sections 11, 11A, 11AB and 11B provide that some taxable supplies must be zero-rated. While all the zero-rating provisions apply to "a supply", some indicate that part of the supply can be zero-rated by using the words "to the extent that" or other equivalent wording. Where a provision of ss 11, 11A, 11AB or 11B requires part of a supply to be zero-rated, the different elements of a single composite supply may be subject to different GST treatments.
66. These different GST treatments are achieved through s 5(14). Section 5(14) applies when a supply is subject to GST at the standard rate but any of the provisions of ss 11, 11A, 11AB or 11B require part of the supply to be zero-rated. If s 5(14) applies, the zero-rated part is treated as being a separate supply. For a more detailed discussion of s 5(14), see "IS 08/01: GST — Role of Section 5(14) of the Goods and Services Tax Act 1985 in Regard to the Zero-rating of Part of a Supply" *Tax Information Bulletin* Vol 20, No 5 (June 2008): 8.

Otherwise, GST treatment follows dominant element

67. If the provisions of ss 11, 11A, 11AB or 11B do not apply to the single composite supply, the GST treatment of that supply will follow the dominant element of the supply. If there is no dominant element (for example, the supply is made up of several equally important elements that are integral to each other), the GST treatment will be determined by the overall characteristics of the single composite supply.

GST treatment of multiple separate supplies

68. If there are multiple separate supplies, the relevant provisions of the Act are applied to each supply. This means that it is necessary to consider each separately identified supply to determine whether any of the specific provisions (such as, for example, s 11(1)(mb)) apply.
69. In some situations, a recipient may pay a global amount for multiple supplies with different GST treatments (for example, taxable supplies and exempt supplies). Section 10(18) provides that GST should be calculated on that part of the consideration that is properly attributable to the taxable supply. This means the consideration must be apportioned between taxable supplies and non-taxable supplies or exempt supplies.

Examples

70. The following examples illustrate how the law applies. All persons mentioned in the examples are GST registered.

Example 1 – Services supplied to overseas students to help them to move to New Zealand

71. Ecological Education Ltd offers education services to students in New Zealand. The education services are intended to provide students with a qualification in eco-management. Almost all of Ecological Education's students are from overseas. To help students moving to New Zealand, Ecological Education provides various pre-arrival services to the students while they are still overseas (for example, interpreting and translating services, assistance with immigration procedures and the completion of enrolment applications). Ecological Education charges the student a single fee for the tuition costs and the pre-arrival services.

Are the pre-arrival services separate zero-rated supplies?

72. No. The pre-arrival services are part of a single composite supply of standard-rated education services, so are also standard-rated.

73. First, it is necessary to identify the supply by considering the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances. It is evident from the arrangement that Ecological Education supplies multiple elements, namely education services to the students in New Zealand, and various pre-arrival services to students while they are still overseas, all for a single fee.

74. To decide whether Ecological Education has made one composite supply or multiple separate supplies it is helpful to consider the true and substantive nature of what is supplied to the student from the recipient's (that is, the student's) perspective. From the student's point of view, the dominant supply is of education services. Considering the relationship between the elements supplied, the pre-arrival services are ancillary or incidental to the supply of education services. The pre-arrival services are not aims in themselves, but are a means of better enjoying the education services. Accordingly, there is a single composite supply of education services that is subject to GST at the standard rate.

Example 2 – Tablet provided as part of mortgage promotion

75. Andrew needs to obtain a mortgage of $250,000 to purchase land for the expansion of his manufacturing business. He approaches New Bank, because of its recent mortgage promotion. He gets his mortgage approved and, as part of the mortgage promotion, he receives a new tablet.

76. If these were separate supplies, the mortgage would be an exempt supply of financial services under s 14(1)(a). The supply of the tablet would be a taxable supply under s 8.

Is the supply of the tablet subject to GST?

77. No. The tablet is an incidental part of a single composite, exempt supply of the mortgage, so is also exempt from GST.

78. The true nature of the legal arrangement is a loan from New Bank to Andrew (secured by a mortgage over the land). The contract also includes a supply of goods from New Bank to Andrew. Therefore, New Bank supplies multiple elements to Andrew, namely a loan and a tablet. The question is whether these two elements are a single composite supply or multiple separate supplies. As with example 1, the nature of the supply has to be considered from the recipient's (that is, Andrew's) perspective.

79. Unlike example 1, the supply of the tablet cannot be considered ancillary to the supply of financial services, because it does not facilitate, contribute to or enable the supply of the dominant part of the transaction (the mortgage). The supply of the tablet does not directly affect the supply of the mortgage in any material sense.

80. However, the supply of the tablet is incidental, minor or peripheral to the dominant element of the supply. Andrew would not have entered into a mortgage simply to receive the tablet. Obtaining the tablet is not an aim in itself. Andrew's aim is to obtain a mortgage. Objectively, the supply of the tablet does not change or facilitate the dominant element, which is the mortgage. The supply of the tablet is also not sufficiently distinct from the supply of the mortgage to make it reasonable to sever and apportion the parts. It is the supply of the mortgage that triggers the supply of the tablet.

81. In this situation, there is a single composite, exempt supply of a mortgage. The supply of the tablet is an incidental or peripheral supply to the dominant supply of GST-exempt financial services. This means all elements of the supply under the agreement are exempt for GST.

Example 3 – Tablet available at reduced price as part of mortgage promotion

82. As a variation to the facts of example 2, Andrew still needs to obtain a mortgage to purchase land for the expansion of his manufacturing business. He approaches New Bank, because of its recent mortgage promotion. New Bank's mortgage promotion is that for new borrowings in the range of what Andrew wants to borrow, it is offering customers the opportunity to purchase for $500 a new tablet valued at $1,500. Andrew's mortgage is approved and, as part of the mortgage promotion, he takes up the opportunity to get a new tablet for $500.

Is the supply of the tablet subject to GST?

83. Yes. The supply of the tablet is separate to the supply of the mortgage. Therefore, although the mortgage is exempt as the supply of financial services, the tablet is a taxable supply.

84. Unlike example 2, the tablet is not incidental to taking out the mortgage. Obtaining the tablet was an aim in itself. While Andrew's primary aim was to obtain a mortgage, obtaining the new tablet was a separate objective. As in example 2, the supply of the tablet does not change or facilitate the dominant element, which is the mortgage. However, in this case the supply of the tablet is sufficiently distinct from the supply of the mortgage to make it reasonable to sever and apportion the elements. The tablet was not part of the supply of the mortgage – it was separately pursued by Andrew for further consideration.

Example 4 – Theatre tickets purchased on credit card and credit card surcharge

85. To celebrate the expansion of his business, Andrew buys theatre tickets for all his employees. Andrew purchases the tickets from the theatre box office using his credit card. The theatre charges Andrew a credit card surcharge.

Is the credit card surcharge a separate exempt supply of financial services?

86. No. The credit card surcharge is part of a single composite supply of standard rated theatre tickets.

87. The true nature of the legal arrangement is for the supply of multiple elements, namely theatre tickets and the facility to pay for those tickets by credit card, with each element itemised and charged for separately. It is necessary to consider whether there is any relationship between the supply of the tickets and the supply of the financial service (being the facility to pay with a credit card). Viewing the arrangement between Andrew and the theatre from Andrew's point of view, the dominant supply is the supply of theatre tickets. While he is paying a surcharge for using his credit card, the dominant supply remains the supply of theatre tickets. Andrew's ability to use his credit card is not an aim in itself. The facility to pay by credit card is ancillary to the dominant supply of the theatre tickets, in the sense that it enables the supply to occur.

88. There is a single composite, taxable supply of theatre tickets. This means all the elements of the supply under the agreement are subject to GST.

Example 5 – Residential accommodation and cleaning services

89. Andrew's parents are looking to move into a villa that is part of a retirement complex. The villa stands alone and, at this stage, Andrew's parents do not require any care. When considering the options, Andrew convinces his parents that they should get the option offered by the retirement complex of having a cleaner come to the villa weekly.

90. If these are separate supplies, the supply of the right to live in the villa would be an exempt supply of residential accommodation under s 14(1)(c). The supply of the cleaning services would be a taxable supply under s 8.

Are the cleaning services subject to GST?

91. Yes. The cleaning services are a separate supply to the supply of the right to live in the villa.

92. The dominant supply is the right to live in the villa. In some respects, the cleaning services could be seen as ancillary or incidental to the right to live in the villa. However, in this case, the cleaning services are not necessary or incidental to the right to live in the villa – they are an extra service that not all recipients require. In this case, a separate amount is charged for the cleaning services. This fact may indicate multiple separate supplies, but it is not determinative. It must still be considered whether the arrangements indicate that Andrew's parents intended to purchase two distinct services. While Andrew's parents' primary aim was to obtain the right to live in the villa, obtaining the cleaning services was a separate objective. In this case the supply of the cleaning services is sufficiently distinct from the supply of the right to live in the villa to make it reasonable to sever and apportion the elements.

Example 6 – Loyalty points with a credit card

93. Electronics Ltd (an electronics retail chain) operates a customer loyalty programme in its retail stores. Registered customers receive loyalty points for shopping at Electronics Ltd and these loyalty points entitle them to future discounts at Electronics Ltd.

94. New Bank wants to expand its credit card business. It decides to enter into an arrangement with Electronics Ltd. Under the terms of the arrangement, New Bank and Electronics Ltd intend to provide additional loyalty points in Electronics Ltd's loyalty programme to registered customers who use the New Bank credit card to purchase goods from Electronics Ltd.

95. New Bank pays Electronics Ltd for services associated with promoting and maintaining the loyalty programme. These services include access to Electronics Ltd's customer database, marketing the loyalty programme (including the provision of all marketing material), encouraging customers to use the New Bank credit card, managing all non-credit card aspects of the loyalty programme, accepting in-store account payments, assisting the retail stores to accept in-store account payments and provide loyalty points, and training the retail store employees on how the loyalty programme works.

96. Electronics Ltd wants to know how it should treat the services it supplies to New Bank for GST purposes.

Should any of the services be exempt as a separate supply of financial services?

97. No. The services are all part of a single composite supply of standard-rated marketing and promotional services.

98. The contract between New Bank and Electronics Ltd provides for the supply of several services from Electronics Ltd to New Bank. It is necessary to consider whether there is any relationship between the various services provided. The focus must be on what is supplied to the recipient. The recipient of these services is New Bank, despite the fact some of the services are supplied directly to New Bank's customers (for example, answering questions about the loyalty programme).

99. The supply could be broken down into separate elements (some taxable at the standard rate and some exempt). However, this would not appropriately reflect what is supplied to the recipient, New Bank. The supply from Electronics Ltd to New Bank is a supply of all the elements. From New Bank's perspective, it has contracted with Electronics Ltd for the supply of all those elements as a single package of marketing and promotional services. It is helpful to consider the relationship between the different elements of the supply when deciding whether Electronics Ltd has made one composite supply or multiple separate supplies to New Bank.

100. The dominant element of the supply to New Bank is marketing and promotional services for the loyalty programme. While Electronics Ltd may, as part of that dominant element, be providing financial services, such as accepting account payments, these are ancillary to the dominant element when packaged together. This is because these parts of the supply are not aims in themselves. They are included so that New Bank can better enjoy the dominant element of the supply of marketing and promotional services. It is also helpful to consider the essential purpose of the transaction between New Bank and Electronics Ltd, namely, the provision of a single package of marketing and promotional services. It would not be reasonable to sever the elements of the transaction into separate supplies.

101. In this situation there is a single composite, taxable supply of marketing and promotional services. The GST treatment of the dominant element of the supply (marketing and promotional services) is a taxable supply at the standard rate. Therefore, the ancillary or incidental supplies are also taxable at the standard rate.

Example 7 – Treatment of transitional services supplied as part of the sale of a business (that includes the supply of land)

102. "QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65 provides an example of the application of the principles set out in this Interpretation Statement.

103. QB 12/07 considers whether transitional services provided by the vendor as part of the sale of a business (that includes the supply of land) will be part of a single composite supply and therefore zero-rated for GST purposes where:

- the services and the sale of the business form part of the same contractual arrangement, and
- the services are not provided for a separately identifiable consideration.

104. The examples consider two fact scenarios. The first scenario is where the vendor provides basic transitional services as part of the sale of the business. The vendor agrees to be onsite for a week from the day of transfer to show the purchaser how the business operates, to answer any questions that the purchaser has and to facilitate a smooth transfer of the business.

105. In this situation there is a single composite, zero-rated supply of a business that includes land. The dominant element of the agreement is the supply of the business (including land). The services are not extensive and are provided for only a short period of time. Further, the nature of the services is to facilitate a smooth transfer of the business to the purchaser. Consequently, the services provided are ancillary and incidental to the supply of the business. They do not constitute an aim in themselves, but rather are a means for the purchaser to better enjoy the supply of the business.

106. The second scenario is where the vendor provides extensive transitional services as part of the sale of the business. The vendor agrees to manage the business for the purchaser for an initial period of 12 months.

107. In this situation there are two separate supplies – one of the land/business and one of transitional services. The transitional services are relatively extensive and are provided over a 12 month period. They are an aim in themselves for the purchaser who requires someone to run the business on an on-going basis. The fact that the services are not provided for a separately identifiable consideration is not determinative. The supply of these transitional services should be standard-rated, as ss 11(1)(mb) and 5(24) do not apply.

108. As noted in the example, no amount of consideration has been attributed to the transitional services. Therefore, the total consideration provided for under the agreement will need to be apportioned between the zero-rated supply (the business/land) and the standard-rated supply (the transitional services).

109. The Commissioner considers that these outcomes are consistent with the general principles set out and applied in this Interpretation Statement.

References

Related rulings/statements

"Financial Planning Fees – GST Treatment" *Tax Information Bulletin* Vol 13, No 7 (July 2001): 37 (IS 0079)

"Goods and Services Tax – GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02)

"IS 08/01: GST – Role of Section 5(14) of the Goods and Services Tax Act 1985 in Regard to the Zero-rating of Part of a Supply" *Tax Information Bulletin* Vol 20, No 5 (June 2008): 8

"QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65

"Zero-rating of Warranty Payments" *Tax Information Bulletin* Vol 14, No 11 (November 2002): 71

Subject references

Apportionment

GST

Multiple supplies

Single supply

Legislative references

Goods and Services Tax Act 1985, ss 5, 8, 10, 11, 11A, 11AB, 11B, 14

Case references

Auckland Institute of Studies Ltd v CIR (2002) 20 NZTC 17,685 (HC)

British Airways plc v C & E Commrs [1990] STC 643 (CA)

Card Protection Plan v C & E Commrs [2001] 2 All ER 143 (HL)

CIR v Gulf Harbour Development Ltd (2004) 21 NZTC 18,915 (CA)

CIR v Smiths City Group Limited (1992) 14 NZTC 9,140 (HC)

College of Estate Management v Customs & Excise Commissioners [2005] UKHL 62, 4 All ER 933

Customs & Excise Commissioners v British Telecommunications Plc [1999] BTC 5,273

Customs & Excise Commissioners v United Biscuits (UK) Limited [1992] STC 325

Customs & Excise Commissioners v Wellington Private Hospital Ltd [1997] STC 445 (EWCA)

Marac Life Assurance Ltd v CIR (1986) 8 NZTC 5,086 (CA)

Metropolitan International Schools v Revenue & Customs Commissioners [2015] UKFTT 517 (TC)

Tumble Tots (UK) Ltd v Revenue & Customs Commissioners [2007] EWHC 103 Ch

Appendix – Legislation

Goods and Services Tax Act 1985

1. Section 5(1), (14), (14B), (15) and (20) provide:

5 Meaning of term "supply"

(1) For the purposes of this Act, the term supply includes all forms of supply.

…

(14) If a supply is charged with a tax under section 8, but section 11, 11A, 11AB, 11B, or 11C requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being a separate supply.

(14B) If part of a supply of an equity security or participatory security is the supply of a right to receive supplies of goods and services that are not exempt supplies, the supply of the right is treated as being a supply of goods and services made for a consideration.

(15) When either of the following supplies are included in a supply, they are deemed to be a separate supply from the supply of any other real property that is included in the supply:

(a) a supply of a principal place of residence:

(b) a supply referred to in section 14(1)(d).

…

(20) A supply of services to which section 11A(1)(ma) applies is treated as the only supply of services for the consideration provided by the warrantor.

2. Section 8(1) provides:

8 Imposition of goods and services tax on supply

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

…

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3. Section 10(18) provides:

10 Value of supply of goods and services

…

(18) Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

…

4. Section 11 provides:

11 Zero-rating of goods

(1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(a) the supplier has entered the goods for export under the Customs and Excise Act 1996 and the goods have been exported by the supplier; or

(b) the goods have been deemed to be entered for export under the Customs and Excise Act 1996 and the goods have been exported by the supplier; or

(c) the supplier has satisfied the Commissioner that the goods have been exported by the supplier to a place outside New Zealand; or

(d) subject to subsection (4), the supplier will enter the goods for export under the Customs and Excise Act 1996 in the course of, or as a condition of, making the supply, and will export the goods; or

(e) subject to subsection (4), the goods will be deemed to be entered for export under the Customs and Excise Act 1996 and will be exported by the supplier in the course of, or as a condition of, making the supply; or

(eb) subject to subsection (4), the goods supplied—

(i) are supplied to a recipient who is a non-resident; and

(ii) have been entered for export under the Customs and Excise Act 1996 by the supplier or will be entered for export by the supplier in the course of or as a condition of making the supply; and

(iii) are exported by the recipient; and

(iv) are not intended by the recipient for later importation into New Zealand for use other than in making taxable supplies or exempt supplies, with the absence of such an intention being confirmed by the recipient in a document retained by the supplier; and

(v) are not used or altered by the recipient before being exported, except to the extent necessary to prepare the goods for export; and

(vi) leave New Zealand under an arrangement agreed by the supplier and the recipient at or before the time of the supply; and

(vii) do not leave New Zealand in the possession of a passenger or crew member of an aircraft or ship; or

(f) goods that would otherwise have been exported are destroyed, die or cease to exist in circumstances beyond the control of both the supplier and the recipient; or

(g) subject to subsection (6), the goods are supplied by a supplier who is licensed under section 12 of the Customs and Excise Act 1996, if—

(i) the supplier has been licensed by the chief executive of the New Zealand Customs Service to operate a sealed bag system; and

(ii) the goods are supplied in accordance with the sealed bag system; and

(iii) the goods are entered, or are deemed to be entered, for export under the Customs and Excise Act 1996; or

(h) the goods and services are supplied—

(i) by a supplier who is licensed under section 12 of the Customs and Excise Act 1996; and

(ii) within an area licensed under section 12 of the Customs and Excise Act 1996 as a customs controlled area for the processing of persons arriving in or departing from New Zealand; and

(iii) to either—

(A) an inbound air traveller; or

(B) an outbound air traveller who picks up the goods upon returning to New Zealand; or

(i) subject to subsection (7), the supply of a boat or an aircraft by way of sale to a recipient who exports the boat or aircraft under its own power to a place outside New Zealand; or

(j) the goods are not situated in New Zealand at the time of supply and—

(i) the goods are not situated in New Zealand at the time of delivery to the recipient:

(ii) the recipient pays tax under section 12 on the importation of the goods into New Zealand; or

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(k) the goods have been supplied in the course of repairing, renovating, modifying or treating goods to which section 11A(1)(h) or 11A(1)(i) applies and the goods supplied—
  (i) are wrought into, affixed to, attached to or otherwise form part of those other goods; or
  (ii) are consumable goods that become unusable or worthless as a direct result of being used in the repair, renovation, modification or treatment process; or
(ka) the goods are supplied for use on, or the use of, a pleasure craft, being a temporary import within the meaning of section 116 of the Customs and Excise Act 1996, that cause or enable the craft to sail, or that ensure the safety of passengers and crew on the craft; or
(l) the goods supplied are consumable stores intended for use on—
  (i) an aircraft on a flight, or going, to a destination outside New Zealand; or
  (ii) a fishing ship outside, or going outside, New Zealand fisheries waters; or
  (iib) a ship, other than a pleasure craft, carrying consumable stores to a foreign-going ship or to a fishing ship that meets the requirements in subparagraph (ii); or
  (iii) a foreign-going ship; or
  (iv) a pleasure craft that is a temporary import within the meaning of section 116 of the Customs and Excise Act 1996 going to a destination outside New Zealand fisheries waters; or
(m) the supply to a registered person of a taxable activity, or part of a taxable activity, that is a going concern at the time of the supply, if—
  (i) the supplier and the recipient agree that the supply is the supply of a going concern, and their agreement is recorded in a document; and
  (ii) the supplier and the recipient intend that the supply is of a taxable activity, or part of a taxable activity, that is capable of being carried on as a going concern by the recipient; or
(mb) the supply wholly or partly consists of land, being a supply—
  (i) made by a registered person to another registered person who acquires the goods with the intention of using them for making taxable supplies; and
  (ii) that is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c); or
(n) the supply of new fine metal, being the first supply of the new fine metal after its refining, by the refiner to a dealer in fine metal, for the purpose of supplying the fine metal for use as an investment item; or
(o) the goods are supplied to or by the Crown as consideration for a supply—
  (i) for which there is no payment of a price; and
  (ii) that is chargeable at the rate of 0% under section 11A(1)(s) or (t); or
(p) the goods are—
  (i) jigs, patterns, templates, dies, punches, and similar machine tools to be used in New Zealand solely to manufacture goods that will be for export from New Zealand; and
  (ii) supplied to a recipient who is a non-resident, and not a registered person.

(2) For the purpose of subsection (1)(n), if a person is both a refiner of and a dealer in fine metal, the new fine metal is treated as having been supplied to the dealer at a time immediately before the making of an exempt supply of the new fine metal.

(3) Subsection (1)(a) to (1)(l) do not apply to a supply of goods by a registered person if—
  (a) the registered person, or another person associated with the registered person, has deducted, under section 20(3), input tax as defined in section 3A(1)(c) in respect of the goods; or
  (b) the goods have been or will be reimported into New Zealand by the supplier.

(3B) Subsection (3)(a) does not apply to a supply of goods if the recipient gives the registered person at or before the time of the supply an undertaking, and records the undertaking in a document, that neither the recipient nor an associated person will cause the goods to be reimported into New Zealand in a condition that is substantially the same as the condition the goods were in when the supply was charged with tax under subsection (1)(a) to (1)(l).

(3C) Despite subsection (3B), a registered person is treated as having supplied goods in the course or furtherance of a taxable activity and must be charged with tax at the rate specified in section 8 if—
  (a) the supply of the goods by the registered person was charged with tax under subsection (1)(a) to (l); and
  (b) the goods are imported into New Zealand; and
  (c) the goods are reacquired by the registered person in substantially the same condition as the condition the goods were in when the supply was charged with tax under subsection (1)(a) to (l); and
  (d) the registered person deducted under section 20(3) input tax as defined in section 3A(1)(c) in relation to the original supply of the goods under subsection (1)(a) to (l).

(3D) Subsection (3C)—

(a) applies at the time the goods are reacquired by the registered person:

(b) does not apply if tax is paid under section 12 on the importation of the goods into New Zealand.

(4) If subsection (1)(d), (e), or (eb) applies and the person required to export the goods does not do so within 28 days beginning on the day of the time of supply or a longer period that the Commissioner has allowed under subsection (5), the supply of the goods must be charged with tax at the rate specified in section 8 despite subsection (1)(d), (e), and (eb) but subject to subsection (1)(a), (1)(b) and subsection (5).

(5) The Commissioner may extend the 28-day period before a supply of goods is charged with tax at the rate specified in section 8 if the Commissioner has determined, after the supplier has applied, that—

(a) circumstances beyond the control of the supplier and the recipient have prevented, or will prevent, the export of the goods within 28 days beginning on the day of the time of supply; or

(b) due to the nature of the supply, it is not practicable for the supplier to export the goods, or a class of the goods, within 28 days beginning on the day of the time of supply.

(6) If subsection (1)(g) applies and the goods cannot be evidenced, as specified by the chief executive of the New Zealand Customs Service in accordance with the sealed bag system, as being exported within 28 days beginning on the day of the time of supply, despite subsection (1)(g), the supply must be charged with tax at the rate specified in section 8.

(7) Subsection (1)(i) applies to the supply of a boat or an aircraft, if—

(a) the boat or aircraft is exported within 60 days beginning on the date on which the recipient or the recipient's agent takes physical possession of it, or within a longer period as the Commissioner may allow under subsection (8); and

(b) the vendor or the purchaser provides the Commissioner with such documentation and undertakings as the Commissioner may require in relation to—

(i) records of the sale of the supply; and

(ii) limitations on dealings in and the uses to which the boat or aircraft will be put before export; and

(iii) the proposed and actual date of export.

(8) The Commissioner may extend the 60-day period if the Commissioner is satisfied, upon the application of the supplier, that circumstances beyond the control of the supplier and the recipient have prevented, or will prevent, the export of the boat or aircraft within the period.

(8B) Whether a supply of goods is zero-rated under subsection (1)(mb) is determined at the time of settlement of the transaction relating to the supply.

(8C) Despite subsections (1)(mb) and (8B), a supplier may choose to apply the provisions of this Act applying before the changes made by the Taxation (GST and Remedial Matters) Act 2010 if they enter into a binding agreement before 1 April 2011 for which the time of supply is on or after that date.

(8D) For the purposes of the zero-rating of land rules,—

(a) a supply that is an assignment or surrender of an interest in land, is a supply under subsection (1)(mb) if it meets the requirements set out in that subsection:

(b) the supply of an interest in land is not a supply under subsection (1)(mb), despite meeting the requirements set out in that subsection if—

(i) the supply is made periodically; and

(ii) for an amount paid or payable under the agreement for the supply in advance of, or contemporaneously with, the supply being made, the payment—

(A) totals 25% or less of the consideration specified in the agreement; and

(B) relates to the longer of 1 year and the shortest possible fixed term of the agreement; and

(C) is not itself a regular payment under the agreement:

(c) a supply of an interest in land by way of a procurement by a third party of an existing lease is a supply under subsection (1)(mb) if it meets the requirements set out in that subsection.

(9) For the purpose of this section—

aircraft has the meaning set out in section 2 of the Civil Aviation Act 1990

consumable stores means—

(a) goods that passengers and crew on board an aircraft or a ship have available to consume; and

(b) goods necessary to operate or maintain an aircraft or a ship, including fuel and lubricants but excluding spare parts and equipment

fishing ship has the meaning set out in section 2 of the Maritime Transport Act 1994

foreign-going ship means a ship on a voyage, or going, to a destination outside New Zealand, other than a pleasure craft or a fishing ship

New Zealand fisheries waters has the meaning set out in section 2 of the Fisheries Act 1996

pleasure craft has the meaning set out in section 2 of the Maritime Transport Act 1994

sealed bag system means a system under which a supplier—

(a) is licensed to operate an export warehouse; and

(b) may, with the authorisation of the chief executive of the New Zealand Customs Service, and subject to any conditions that the chief executive may specify, supply goods in a sealed bag to individuals intending to travel overseas within 5 days beginning on the day of the time of supply; and

(c) must provide evidence that the goods have been exported from New Zealand within 5 days beginning on the day of the time of supply, and if conditions have been specified by the chief executive of the New Zealand Customs Service, in accordance with those conditions

ship has the meaning set out in section 2 of the Maritime Transport Act 1994.

5. Section 11A provides:

11A Zero-rating of services

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(a) the services, not being ancillary transport activities such as loading, unloading and handling, are the transport of passengers or goods—

(i) from a place outside New Zealand to another place outside New Zealand; or

(ii) from a place in New Zealand to a place outside New Zealand; or

(iii) from a place outside New Zealand to a place in New Zealand; or

(b) the services are the transport of passengers from a place in New Zealand to another place in New Zealand to the extent that the transport is by aircraft, as defined in section 2 of the Civil Aviation Act 1990, and is international carriage for the purpose of that Act; or

(bb) the services are the transport of passengers from a place in New Zealand to another place in New Zealand by sea as part of an international cruise if either the first place of departure, or the final place of destination, of the cruise is outside New Zealand; or

(c) the services, including ancillary transport activities such as loading, unloading and handling, are the transport of goods from a place in New Zealand to another place in New Zealand to the extent that the services are supplied by the same supplier as part of the supply of services to which paragraph (a)(ii) or (a)(iii) applies; or

(cb) the services, including ancillary activities such as loading, unloading, handling and storing, are the transport of household goods from a place in New Zealand to another place in New Zealand, if—

(i) the services are supplied to a person who, at the time of the supply, is non-resident and outside New Zealand; and

(ii) the goods are entered for home consumption under the Customs and Excise Act 1996; and

(iii) the arrangement for the supply of the services is made before the goods are entered; and

(iv) the services are reasonably expected to be completed within the period of 28 days that begins on the date of entry of the goods; or

(d) the services are the insuring, or the arranging of the insurance, or the arranging of the transport of passengers or goods to which any one of paragraphs (a) to (cb) applies; or

(e) the services are supplied directly in connection with land situated outside New Zealand or any improvement to the land; or

(f) the services are supplied directly in connection with moveable personal property, other than choses in action, situated outside New Zealand when the services are performed; or

(g) the services are supplied to overseas postal organisations for the delivery in New Zealand of postal articles mailed outside New Zealand; or

(h) the services are supplied directly in connection with goods supplied from outside New Zealand and whose destination is outside New Zealand, including stores for craft, only if the goods are not removed from the ship or aircraft in which they arrived while the ship or aircraft is in New Zealand; or

(i) the services are supplied directly in connection with goods referred to in section 116 of the Customs and Excise Act 1996; or

(j) the services are physically performed outside New Zealand or are the arranging of services that are physically performed outside New Zealand, other than a supply of remote services provided to a person resident in New Zealand who is not a registered person; or

(k) subject to subsection (2), the services are supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed, not being services which are—

(i) supplied directly in connection with—

(A) land situated in New Zealand or any improvement to the land; or

(B) moveable personal property, other than choses in action or goods to which paragraph (h) or (i) applies, situated in New Zealand at the time the services are performed; or

(ii) the acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand; or

(l) subject to subsection (2), the services are the supply of information to a person who is a non-resident and who is outside New Zealand at the time the services are performed, if the services are supplied directly in connection with moveable personal property situated in New Zealand at the time the services are performed; or

(m) the services are supplied—

(i) directly in connection with goods, the supply of which was subject to any one of section 11(1)(a) to (eb); and

(ii) to a recipient who, when the services are performed, is a non-resident and outside New Zealand; or

(maa) the services are supplied—

(i) directly in connection with goods, the supply of which is subject to section 11(1)(p); and

(ii) to a recipient who, when the services are performed, is a non-resident and not a registered person; or

(ma) the services relate to goods under warranty to the extent that the services are—

(i) provided under the warranty; and

(ii) supplied for consideration that is given by a warrantor who is a non-resident, not a registered person and who is outside New Zealand at the time the services are performed; and

(iii) in respect of goods that were subject to tax under section 12(1); or

(n) subject to subsection (4), the services are—

(i) the filing, prosecution, granting, maintenance, transfer, assignment, licensing or enforcement of intellectual property rights, including patents, designs, trade marks, copyrights, plant variety rights, know-how, confidential information, trade secrets or similar rights; or

(ii) other services in respect of rights listed in subparagraph (i), including services involved in the making of searches, the giving of advice, opposing a grant or seeking the revocation of the rights, or opposing steps taken to enforce the rights; or

(o) the services are the acceptance of an obligation to refrain from pursuing or exercising in whole or in part rights listed in paragraph (n) to the extent that the rights are for use outside New Zealand; or

(p) the services are the acceptance of an obligation to refrain from carrying on a taxable activity if the activity would have occurred outside New Zealand; or

(q) the services are financial services that are supplied in respect of a taxable period, by a registered person who has made an election under section 20F, to a registered person who makes supplies of goods and services such that taxable supplies that are not charged with tax at the rate of 0% under this paragraph or under paragraph (r) make up not less than 75% of the total value of the supplies in respect of—

(i) a 12-month period that includes the taxable period; or

(ii) a period acceptable to the Commissioner; or

(r) the services are financial services that are supplied in respect of a taxable period, by a registered person who has made an election under section 20F, to a person who is a member of a group of companies for the purposes of section IA 6 of the Income Tax Act 2007 and—

(i) the members of the group make supplies of goods and services to persons who are not members of the group in respect of—

(A) a 12-month period that includes the taxable period; or

(B) a period acceptable to the Commissioner; and

(ii) not less than 75% of the total value of the supplies referred to in subparagraph (i) consists of taxable supplies that are not charged with tax at the rate of 0% under this paragraph or under paragraph (q); or

(s) the services are an emissions unit and the supply is the transfer of the emissions unit, other than a transfer by the Crown under—

(i) an agreement relating to a project to reduce emissions:

(ii) a negotiated greenhouse agreement, to a person because the person exceeds the milestone targets under the agreement:

(t) the services are an emissions unit, and the supply is the surrender of the emissions unit under section 63 of the Climate Change Response Act 2002; or

(u) the services are supplied to or by the Crown as consideration for a supply—

(i) for which there is no payment of a price; and

(ii) that is chargeable at the rate of 0% under paragraph (s) or (t); or

(v) *[Repealed]*

(w) the supply is a sale or other disposal of services that are a unit—

(i) issued by reference to the sequestration, or avoidance of emission, of human-induced greenhouse gases; and

(ii) other than an emissions unit; and

(iii) verified to an internationally recognised standard; or

(x) the services are remote services to which section 8(3)(c) applies that are provided to a registered person and the supplier has chosen under section 8(4D) to treat the supply as made in New Zealand.

(1B) Subsection (1)(j) does not apply to a supply of services that is treated by section 8(4B) as being made in New Zealand unless the nature of the services is such that the services can be physically received at no time and place other than the time and place at which the services are physically performed.

(2) Subsection (1)(k) and (1)(l) do not apply to a supply of services under an agreement that is entered into, whether directly or indirectly, with a person (person A) who is a non-resident if—

(a) the performance of the services is, or it is reasonably foreseeable at the time the agreement is entered into that the performance of the services will be, received in New Zealand by another person (person B), including—

(i) an employee of person A; or

(ii) if person A is a company, a director of the company; and

(b) it is reasonably foreseeable, at the time the agreement is entered into, that person B will not receive the performance of the services in the course of making taxable or exempt supplies.

(3) For the purpose of subsection (1)(k), (1)(l) and (1)(ma), and subsection (1)(n) as modified by subsection (4)(b), outside New Zealand, for a company or an unincorporated body that is not resident, includes a minor presence in New Zealand, or a presence that is not effectively connected with the supply.

(3B) For the purpose of subsection (1)(k), outside New Zealand, for a natural person, includes a minor presence in New Zealand that is not directly in connection with the supply.

(4) Subsection (1)(n) applies only to the extent that—

(a) the rights are for use outside New Zealand; or

(b) the services are supplied to a person who is a non-resident and who is outside New Zealand when the services are performed.

(5) This section does not apply to supplies of telecommunications services.

(6) The availability of a deduction under subsection (1)(q) and (r) must be determined using a method allowed by section 20E.

(7) Subsection (1)(x) does not apply to a supply of services for which the supplier subsequently makes an election under section 24(5B).

6. Section 11AB provides:

11AB Zero-rating of telecommunications services

A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% if—

(a) the services are the supply of telecommunications services to an overseas telecommunications supplier by a telecommunications supplier who is a resident; or

(b) the services are the supply of telecommunications services to a person, not being an overseas telecommunications supplier, for a telecommunications service that is initiated outside New Zealand under section 8(9).

7. Section 11B provides:

11B Zero-rating of some supplies by territorial authorities, some supplies involving contributions to local authorities

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% if the supplier is a territorial authority and the consideration for the supply is proceeds from the local authorities petroleum tax paid to the supplier under section 198 of the Local Government Act 1974.

(1B) If a supply under section 5(7B) of goods and services by a local authority to a registered person is chargeable with tax under section 8, the supply must be charged at the rate of 0% to the extent that the contribution made by the registered person to the local authority consists of land.

(1C) If a supply under section 5(7C) of goods and services by a person to a local authority is chargeable with tax under section 8, the supply must be charged at the rate of 0% if the local authority is a registered person.

(1D) *[Repealed]*

(1E) *[Repealed]*

(2) For the purpose of subsection (1)—

local authorities petroleum tax is local authorities petroleum tax levied in accordance with Part 11 of the Local Government Act 1974

territorial authority means a territorial authority within the meaning of the Local Government Act 2002.

8. Section 14(1)(a) and (c) and (1B)(a)–(c) provides:

14 Exempt supplies

(1) The following supplies of goods and services shall be exempt from tax:

(a) the supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being a supply referred to in subsection (1B):

…

(c) the supply of accommodation in any dwelling by way of—

(i) hire; or

(ii) a service occupancy agreement; or

(iii) a licence to occupy:

…

(1B) The following supplies are excluded from the exemption under subsection (1):

(a) a supply of financial services that, in the absence of subsection (1)(a), would be charged with tax at the rate of zero per cent under section 11A:

(b) a supply described in paragraph (b) of the definition of "associated supply":

(c) a supply of goods and services which (although being part of a supply of goods and services which, but for this paragraph, would be an exempt supply under subsection (1)(a)) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which subsection (1)(a) applies.

…

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 17/01: Depreciation Treatment For "Buildings With Prefabricated Stressed-Skin Insulation Panels"

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

This Question We've Been Asked provides guidance for both taxpayers and Inland Revenue staff on which buildings the Commissioner considers come within the asset class "Buildings with prefabricated stressed-skin insulation panels" in the "Buildings and Structures" asset category in the Commissioner's Table of Depreciation Rates.

Question

1. What buildings come within the asset class "Buildings with prefabricated stressed-skin insulation panels"?

Answer

2. The asset class "Buildings with prefabricated stressed-skin insulation panels" (sandwich panels) includes buildings[1] where:
   - The structural framework of the building is of a material other than sandwich panels and the building can be categorised as a "shade-roof structure", or
   - The structural framework of the building is of a material other than sandwich panels and no less than 75% of the exterior cladding of the building is predominantly made using sandwich panels. In calculating this 75% threshold:
     - The windows and doors of a building are ignored and treated as being constructed of the same material as that which surrounds them.
     - Unless the roof of a building is constructed solely or partly using sandwich panels, the roof of the building is ignored and the calculation focuses only on the exterior cladding used to construct the side walls of the building. Where the roof is constructed solely or partly using sandwich panels, the calculation should focus on the square metre area of the exterior cladding of the entire building (that is, the square metre area of both the side walls and roof of the building), or
   - Sandwich panels form the core of the structural framework of the building; the building is constructed solely of interlocking sandwich panels without any other form of frame construction (steel, for instance).

Background

3. In *Tax Information Bulletin* Vol 27, No 10 (November 2015) the Commissioner published QB 15/12 *Depreciation treatment for "Buildings with prefabricated stressed-skin insulation panels"* (QB 15/12). Feedback received since this item was published indicates that taxpayers have found its contents difficult to understand and apply in practice. In order to provide greater clarity this item updates and replaces QB 15/12.
4. A prefabricated stressed-skin insulation panel comprises a foam core sandwiched between two "skins". The core is most commonly made from polyurethane or styrene foam and is both durable and light weight. The "skin" is most commonly made from stainless steel, aluminium or plain galvanised steel. These panels are referred to as "sandwich panels".
5. Since the 1970's, the use of sandwich panels has been a cost-efficient element in the construction of buildings where hygienic food storage is required; coolstores and meat or fish processing facilities for example. Their use enables product to be held within a defined temperature range and so more easily meet storage, handling and hygiene regulations as well as client requirements for a finished product (chilled rather than frozen meat, for example).
6. Historically, the use of sandwich panels was limited to lining the internal walls of a building for insulation purposes, with (generally) steel being used for the framing, roofing and external weather cladding of the building. However, as sandwich panel quality and manufacturing techniques improved, sandwich panels have been used as unprotected weather cladding

[1] For the meaning of the term "building" in the context of the depreciation provisions, please refer to Interpretation Statement IS 10/02: "Meaning of 'building' in the depreciation provisions" (*Tax Information Bulletin* Vol 22, No 5 (June 2010): 24).

and insulation for the building or even as the core structural element, weather cladding and insulation for the building.

7. The "Buildings with prefabricated stressed-skin insulation panels" asset class appears in the "Building and Structures" asset category in the Commissioner's Table of Depreciation Rates ("Depreciation Table") and has a depreciation rate of 4.5% diminishing value (DV) or 3% straight line value, based on an estimated useful life (EUL) of 33.3 years.

Discussion

8. In the asset categories contained in Determination DEP 1: *Tax Depreciation Rates General Determination Number 1* (DEP 1), the building asset classes are initially described by the structural/construction method used (for example, *Buildings with steel or steel and timber framing*). In some cases these generally described building classes will be further, more narrowly, described by the activity the building houses (for example, *Fertiliser works*, *Mushroom factories*). The asset class "Buildings with prefabricated stressed-skin insulation panels" is a reference to an element of the construction, rather than to an activity that is being carried on within the structure.

9. Used in this context, the word "with" can be defined as being either "accompanied by" or "material used for a purpose"[2]. Given these definitions it is the Commissioner's view that, to fall within this asset class a building will either need to be constructed solely of sandwich panels or constructed using other materials (steel for instance) but "accompanied by" sandwich panels (usually as cladding and/or insulation). As has already been stated, the wording used to describe this class of building is not a reference to any activity that may be undertaken within the building. This being so, the EUL that has been set for this asset class assumes that the EUL will not be affected by the activities undertaken within the building[3].

10. Given all of the above, it is the Commissioner's view is that the prefabricated stressed-skin insulation panels asset class could include either the building's cladding or the framing structure, as follows:

The structural framework of the building is of a material other than sandwich panels and the building can be categorised as a "shade-roof structure"

11. Historically steel has been the predominant material used in the framing of buildings that also use sandwich panels, due to steel's economy and resilience in low temperature environments. Historically, coolstore buildings have been an example of this. Typically, the building will be constructed using steel framing with sheet metal cladding that acted as a weather enclosure. The insulated building will be created by lining the inside of the metal clad building with sandwich panels to form a fully insulated "box". Where a structure is fully insulated in this way it is known as a shade-roof structure.

12. As these shade-roof structures are "accompanied by" sandwich panels, they fall within the asset class *Buildings with prefabricated stressed-skin insulation panels*.

The structural framework of the building is of a material other than sandwich panels and no less than 75% of the exterior cladding of the building is predominantly made using sandwich panels

13. In some instances the exterior cladding of a building may be constructed from mixed materials. For example, a building has steel framing with most of the building being clad using sandwich panels. There is however a small administration room at one end of the building that is built from concrete blocks. Alternatively, the steel framed building may be largely constructed using concrete blocks, but have a small coolstore facility attached that is constructed of sandwich panels.

14. Where the exterior cladding of a building is made from mixed construction materials, the Commissioner will take into account the overall percentage of the different materials used. If, overall, 75% or more of the exterior wall cladding of the building is made from sandwich panels, the Commissioner considers that the building comes within the asset class *Buildings with prefabricated stressed-skin insulation panels.*

15. The CIR arrived at this 75% threshold after receiving specialist valuation advice. This threshold is indicative of the "tipping point" at which the EUL of the building is negatively impacted by the use of sandwich panels. It is the CIR's view that, where less than 75% of the exterior cladding of the building is made from sandwich panels then, subject to normal and reasonable maintenance being maintained[4], this type of building will generally have a EUL of 50 years.

16. Whether 75% of the building is constructed using sandwich panels is calculated using the following formula:

$$\frac{\text{Square metre area of sandwich panels used as external cladding}}{\text{Total square metre area of all of the building's external cladding}}$$

17. In calculating the square metre area the following matters are to be taken into account:
   - The windows and doors of a building are ignored and treated as being constructed of the same material as that which

[2] Concise Oxford English Dictionary.

[3] This is further discussed at [18].

[4] Per the definition of *estimated useful life* contained in section EE 63(1) of the Income Tax Act 2007.

QUESTIONS WE'VE BEEN ASKED

surrounds them.

- Unless the roof of a building is constructed solely or partly using sandwich panels, the roof of the building is ignored and the calculation focuses only on the exterior cladding used to construct the side walls of the building. Where the roof is constructed solely or partly using sandwich panels, the calculation should focus on the square metre area of the exterior cladding of the entire building (that is, the square metre area of both the side walls and roof of the building).

18. As previously stated (at [9]), this 75% threshold assumes that there are no other factors that would affect the EUL of that class of building. Where there are other factors that may affect the EUL of a class of building in a taxpayer's possession, then a taxpayer is able to make a provisional depreciation determination application to the CIR[5].

Sandwich panels form the core of the structural framework of the building; the building is constructed solely of interlocking sandwich panels without any other form of frame construction (steel, for instance)

19. As manufacturing techniques and sandwich panel quality has improved, sandwich panels are increasingly being used as unprotected cladding against external weather environments. This decreased use of the more conventional sheet-metal cladding has seen sandwich panels being used as the structural element, weather cladding and insulation of buildings. As the building is constructed solely from sandwich panels, the building comes within the asset class Buildings with prefabricated stressed-skin insulation panels.

Changing a depreciation rate

20. In limited circumstances a taxpayer can change the depreciation rate that they use to depreciate an item of depreciable property. For example, where the taxpayer has been using an incorrect rate.

21. For further guidance on changing to a different depreciation rate please refer to QB 15/03: Income tax – changing to a different depreciation rate for an item of depreciable property (*Tax Information Bulletin* Vol 27, No 4 (May 2015): 30)[6].

[5] An example of this occurring is described in *Determination PROV 24: Provisional depreciation rate for mushroom factory building and plant*. In that case the CIR accepted that the EUL of these specialised buildings was affected because they are exposed to a wet, humid and corrosive environment due to the material that is used in growing mushrooms and the environment that mushrooms need to grow successfully.

[6] More information on QB 15/03 can be found at **www.ird.govt.nz** (search term "QB 15/03").

QB 17/02: Income tax – date of acquisition of land, and start date for 2-year bright-line test

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

This Question We've Been Asked (QWBA) is about ss CB 6A and CB 15B.

Some of the land provisions in the Act (ss CB 6, CB 7, CB 9, CB 10, CB 12, CB 14 and CB 19) require identification of the date that someone acquired land. This can be relevant to the provisions that:

- involve 10-year timeframes;
- might apply if at the time the person acquired the land they were, or were associated with, someone in the business of dealing in land, developing or subdividing land, or building; and
- might apply depending on the person's intended use of the land, or their purpose or intention at the time they acquired the land.

This QWBA explains when someone acquires land for the purposes of those provisions. It also sets out when the 2-year period starts for the bright-line test in s CB 6A. The date of acquisition and the start date for the 2-year period are usually different dates.

This QWBA updates the Commissioner's previously published views in two respects.

- It qualifies a statement in the item "Taxation (Bright-line Test for Residential Land) Act 2015" *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78. That item suggests that the date someone acquires their first estate or interest in land (relevant to whether the bright-line legislation potentially applies to them) is the same as when they acquire land under s CB 15B. While that is true in most cases (ie, in a typical land purchase), there are some exceptions. See [27] on this point.
- It supersedes "Taxation (Bright-line Test for Residential Land) Act 2015" *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78 in relation to the application of the bright-line test to nominations. See from [46] on this point.

Question

1. On what date is a person treated as acquiring land for the purposes of the land sale rules in ss CB 6 to CB 14? And when does the 2-year period for the bright-line test in s CB 6A start?

Answer

2. Table 1 shows the date on which land is acquired in different situations, for the purposes of the land sale rules in ss CB 6 to CB 14. Table 2 shows the date on which the 2-year period for the bright-line test in s CB 6A starts in different situations.

Table 1 – When land is acquired for the purposes of the land sale rules in ss CB 6 to CB 14

Circumstance	When land is acquired for tax purposes *(other than the 2-year bright-line test)*
Standard purchase of land.	When a binding contract to purchase the land is formed (even if some conditions still need to be met – see further from [42]).
Land other than freehold (eg, a leasehold estate, an equitable interest in land, or an option to acquire land).	The date on which the person first had an interest in the land (subject to the rest of the rules in this table).
Land acquired from the exercise of an option.	When the person exercised the option.
Agreement for acquisition of land on behalf of a company not yet formed.	The date the agreement was entered into.
Land that a person subdivides.	The date the person acquired the original undivided piece of land.
Land acquired from an associated person.	The date the associated person acquired the land *(relevant for only ss CB 7 to CB 12 and CB 14).*
• Special rules (see [86] and [87]) about when land is treated as acquired might apply if a person acquired the land by way of a: - settlement of relationship property; - distribution on someone's death; - distribution from a trust; - transfer of value from a company; - gift; or - resident's restricted amalgamation.	

Table 2 – When the 2-year period for the bright-line test starts

(relevant if the first interest in the land was acquired on or after 1 October 2015 – see further from [22])

Circumstance	Start of the 2-year period
Standard purchase of land.	When the land transfer is registered and the person gets the legal title. (If the land is held in a trust, transfers because of a change of trustee(s) will not reset the start date. The start date is the date of registration of the transfer of the land into the trust.)
If a person had an agreement to acquire freehold land on the completion of a development or subdivision, and they subsequently acquired the land (discussed at [32]).	The date the person entered into the contract to acquire the land.
If a person acquired land and subsequently subdivided it.	The date of registration of the transfer of the original undivided piece of land to the person. (If the land is held in a trust, transfers because of a change of trustee(s) will not reset the start date. The start date is the date of registration of the transfer of the original undivided piece of land into the trust.) OR If the title for the undivided land was not registered to the person before they dispose of the divided land, the start date will be the date they acquired an estate or interest in the original undivided piece of land. This is determined under the standard rules discussed in this QWBA.
Lease with perpetual right of renewal converted into freehold title.	The date the person was first granted the leasehold estate.
Settlement of relationship property.	The date the transfer of the land to the transferor under the settlement was registered (or the date they acquired it, if there was no registered transfer to them).
Where no title is registered to a person before the earliest of the date they have an agreement to dispose of the land or the date they in fact dispose of it.	When the person acquired an estate or interest in the land they are disposing of. This is determined in the same way as for the general rule in s CB 15(1) – see from [42]. For these purposes, the special rules about when land is acquired **do not apply** (ie, the rules for land acquired from the exercise of an option, land acquired under an agreement for the acquisition of land on behalf of a company not yet formed, land acquired from an associated person, and the special rules mentioned at [86] and [87]).

3. Some of the land provisions require identification of the date that someone acquired land (see further at [12]). The main rules about when a person is treated as acquiring land for tax purposes are set out in s CB 15B (see Table 1 and from [36]).

4. There are special rules about when the 2-year period for the bright-line test in s CB 6A starts (see Table 2 and from [27]). This date is generally not the same as when the person acquires land for the other tax provisions.

5. The general rule in s CB 15B is that someone acquires land on the date that they first have an estate or interest in the land or first have an option to acquire the land (the "first interest").

6. A person will often acquire different interests (each being "land") in the same piece of underlying physical land at different times. For example, in a typical purchase of land situation, the purchaser acquires an equitable interest in the estate when a binding contract to purchase the land is formed, which is before they acquire the legal interest (when the land is transferred to them). What is relevant is when they acquired their **first interest** in the land (ie, the particular estate) that they are disposing of. This will typically be when a binding contract to purchase the land is formed, even if some conditions still need to be met (such as obtaining finance, a building report or a Land Information Memorandum (LIM)) – see further from [42].

7. Any other interests the person has had in the same underlying physical land will not be relevant. For example, if they might be taxed on the sale of a freehold estate and the date of acquisition is relevant to that, the fact they previously had a leasehold interest in the land will not be relevant. They are treated as acquiring the freehold estate on the date they first had an interest in **that** estate.

8. Where someone acquires land by way of an option, the date of acquisition will be the date they exercised the option.
9. Where a company acquires land under an agreement entered into on its behalf before it was formed, the company is treated as acquiring the land when the agreement was entered into (see further from [83]).
10. If someone acquires land from an associated person, for the purposes of some provisions (ss CB 7 to CB 12 and CB 14) they are treated as acquiring it on the date that the associated person acquired it (s CB 15(2)).
11. A person may be treated as having a different date of acquisition than the date under s CB 15B in some other situations; for example, if they acquired the land on a settlement of relationship property, on a distribution on someone's death, on a distribution from a trust, on a transfer of value from a company, or as a gift (see subparts FB and FC), or on a resident's restricted amalgamation (see s FO 17).

Explanation

Relevance of the date of acquisition of land

12. Some of the land provisions require identification of **when** a person acquired land. The date someone acquired land is relevant to the following provisions:

    Section CB 6

    - If a person acquired land for the purpose of disposing of it, or with the intention of disposing of it, the amount they derive on the disposal of the land will be income (if no exclusion applies). Therefore, it is necessary to look at what the person's purposes and intentions were **when they acquired the land**.

    Sections CB 7, CB 9, CB 10, CB 12, CB 14 and CB 19

    - The date of acquisition is relevant to these provisions because:
      - in some circumstances, if a person disposes of land or commences an undertaking or scheme **within 10 years of when they acquired the land**, the sale proceeds will be income; or
      - it is necessary to identify whether **at the time a person acquired land** they were, or were associated with, someone in the business of dealing in land, developing or subdividing land, or building (which may mean certain taxing provisions apply); or
      - the person's intended use of the land a**t the time they acquired it** is relevant.

Start date for the 2-year bright-line test

13. If none of ss CB 6 to CB 12 apply, the 2-year bright-line test (in s CB 6A) may tax any gains from residential land if someone sells or disposes of the land within two years of their bright-line start date. It is necessary to identify when the 2-year period for the bright-line test in s CB 6A starts, so the person can determine if they are potentially taxed under that provision. As noted at [4], there are special rules about when the 2-year period starts, and this date is generally not the same as when the person acquires land for the other tax provisions. The start date for the 2-year bright-line test is discussed from [27].

Why we have been asked to clarify the date of acquisition of land

14. Section CB 15B was enacted to clarify when land is acquired for tax purposes. Section CB 15B applies for the land provisions in subpart CB, except the 2-year bright-line test. It was suggested that some explanation about how s CB 15B operates would be useful. In particular, the Commissioner has been asked to confirm when a person will acquire an estate or interest in land for the purposes of s CB 15B, and to provide examples of the date of acquisition of land in different scenarios.
15. Because in most cases the 2-year period for the bright-line test in s CB 6A does not start on the date land is acquired under s CB 15B, this QWBA also sets out when the bright-line period starts in different situations.

Date of disposal of land

16. In most cases, the date that land is acquired for the purposes of the land provisions will not be the date it is disposed of by the vendor or transferor. This QWBA does not consider the date of disposal of land.

Definition of "land"

17. "Land" is defined in s YA 1 as including any estate or interest in land, and as including an option to acquire land or an estate or interest in land:

    YA 1 Definitions

    In this Act, unless the context requires otherwise,—

    …

land—

(a) includes any estate or interest in land:

(b) includes an option to acquire land or an estate or interest in land:

(c) does not include a mortgage:

…

[Emphasis added]

18. “Estate”, “interest”, “estate or interest in land” and similar terms are defined as meaning:

YA 1 Definitions

In this Act, unless the context requires otherwise,—

…

estate in relation to land, **interest** in relation to land, **estate or interest in land, estate in land, interest in land**, and similar terms —

(a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and

(b) include a right, whether direct or through a trustee or otherwise, to—

(i) the possession of the land (for example: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952):

(ii) the receipt of the rents or profits from the land:

(iii) the proceeds of the disposal of the land; and

(c) do not include a mortgage

19. Any estate or interest in land (whether legal or equitable, and whether vested or contingent) is “land”, and an option to acquire land or an estate or interest in land is also “land”.

20. The land sale rules in the Act can apply to the disposal of any estate or interest that is “land” as defined.

The 2-year bright-line test

21. As noted at [13], the 2-year bright-line test can only potentially apply if none of the land sale rules in ss CB 6 to CB 12 apply. While it is necessary to consider the application of ss CB 6 to CB 12 before considering the 2-year bright-line test, the following discussion looks at the start date for the bright-line test before going on to consider when land is acquired for the purposes of the other land sale rules. This is because the examples throughout the discussion of the date of acquisition rules also note when the bright-line start date would be.

Application of the 2-year bright-line legislation

22. The 2-year bright-line test came into force on 1 October 2015. It can only potentially apply when someone disposes of land if they **first acquired an estate or interest in that land on or after 1 October 2015.**[1]

23. In a typical land purchase, the purchaser will first acquire an interest in the land when a binding contract to purchase the land is formed (even if some conditions still need to be met). And, if that date is on or after 1 October 2015, the bright-line legislation could potentially apply to their disposal of the land.

24. In most cases, the date on which someone first acquires an estate or interest in land (which is what is relevant to whether the bright-line legislation can apply to them) is **the same** as the date they are treated as acquiring the land for the purposes of the land provisions in ss CB 6 to CB 14. This is the case in a typical land purchase.

25. But, in some situations, the date on which someone first acquires an estate or interest in land will **not be the same** date as when they are treated as acquiring land for the purposes of the land provisions in ss CB 6 to CB 14. For example, if they acquire land through the exercise of an option, their date of acquisition for ss CB 6 to CB 14 will be the date they exercise the option. But the relevant date for determining if the bright-line legislation potentially applies is the date that they first acquired an interest in the land. In most situations, this would be when the option was granted to them. In a situation where the person had a “first right option” to acquire the land (eg, a right of first refusal or a right of first offer), they would typically first acquire an interest in the land when the owner makes an offer in accordance with the “first right option” (see *Motor Works Ltd v Westminster Auto Services Ltd* [1997] 1 NZLR 762 (HC)). Similarly, the date of acquisition and the date someone first acquires an estate or interest in land will be different if they are a company that acquired land under an agreement entered into on its behalf before it was formed, or in the situations mentioned at [11]. In all of those situations it is necessary to consider land law principles to determine the point at which the person first acquired an interest in the land and, therefore, whether the bright-line legislation could apply to them (ie, if the date they first acquired an interest in the land was on or after 1 October 2015).

[1] Section 4(2) of the Taxation (Bright-line Test for Residential Land) Act 2015.

26. The item "Taxation (Bright-line Test for Residential Land) Act 2015" *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78 suggests that the date someone acquires their first estate or interest in land is the same as when they acquire land under s CB 15B. As noted at [24], while that is true in most cases (ie, in a typical land purchase), the situations mentioned at [25] are exceptions to that. This QWBA qualifies the *Tax Information Bulletin* item in this respect.

Start of the 2-year bright-line period

27. If none of the land sale rules in ss CB 6 to CB 12 (see [12]) apply, the 2-year bright-line test (in s CB 6A) may tax any gains from **residential land**, if someone enters into an agreement to dispose of the land or in fact disposes of it within two years of their bright-line start date. It is necessary to identify when the 2-year period for the bright-line test in s CB 6A starts, so the person can determine if they are potentially taxed under that provision. (Note that in some situations the bright-line test will not apply; for example, if the person satisfies the main home exclusion (s CB 16A).)

28. The following paragraphs explain the special rules about when the 2-year period for the bright-line test starts in different situations.

29. If a document transferring the land to a person was registered under the Land Transfer Act 1952[2] on or before they sell or dispose of the land, the date of registration will be the start date for the 2-year bright-line test. **In a typical land purchase, this will mean that the 2-year period starts when the land transfer was registered and the purchaser got the legal title**.

30. If the land is held in a trust, transfers because of a change of trustee(s) will not reset the start date. The start date is the date of registration of the transfer of the land into the trust. But, if the land was transferred out of the trust and then back into the trust at a later date, the start date would be reset at that point.

31. If there was no registered transfer of the land to someone on or before the date they sell or dispose of the land, the 2-year period will start when they acquired the relevant estate or interest in land. This is determined under the standard rules, discussed from [42].

32. If someone had an interest in relation to freehold land that was contingent on the completion of a development or subdivision, and they subsequently acquired the land when the development or subdivision was completed, the 2-year period will start on the date they acquired the contingent interest. For example, if someone entered into a contract to acquire land that was to be subdivided, there would not be a title for the specific land they were buying at the time they entered into the contract. Therefore, their interest in the land is contingent on the completion of the subdivision. This is referred to as buying land "off the plans". If, after the subdivision is completed, the sale is finalised and the title is transferred to the person, the 2-year period will start on the date that they entered into the binding contract, not the date the title was transferred to them. If the person sold or disposed of their contingent interest in the land and never obtained the title, this would be a disposal of land and the 2-year bright-line test could apply if none of ss CB 6 to CB 12 apply. The start date for the 2-year period in that situation would also be the date that they entered into the binding contract.

33. If someone acquired land and subsequently subdivided it, the 2-year period for each of the resulting lots will start on the date of registration of the transfer of the original undivided piece of land to them. The fact that separate new titles were issued is not relevant. If the title for the undivided land was not registered to them before they dispose of the divided land, the start date will be the date they acquired an estate or interest in the original undivided piece of land. This is determined under the standard rules, discussed from [42].

34. If someone had a lease with a perpetual right of renewal that they converted into freehold land, the 2-year period starts when the leasehold estate was granted.

35. On the breakdown of a relationship, land may be transferred from one party to the other as part of the settlement of relationship property. In that situation, the transfer between the parties to the relationship property agreement will generally not give the party who is acquiring the land a new start date. The 2-year period for the person acquiring the land on the settlement will start on the date that the instrument transferring the land to the transferor under the settlement was registered (or the date the transferor acquired it, if there was no registered transfer to them).

When land is acquired for the land provisions other than the 2-year bright-line test

36. Any estate or interest in land (whether legal or equitable, and whether vested or contingent) is "land", and an option to acquire land or an estate or interest in land is also "land".

37. Given this, a person will often acquire different estates or interests (each being "land") in the same piece of underlying physical land at different times. For example, during the typical course of acquisition of a freehold estate in fee simple, a person will usually acquire an equitable interest in the estate before acquiring the legal interest in the estate.

[2] Or a similar foreign law if the land is outside New Zealand (ss CB 6A(1)(a)(ii) and CB 6A(2)(a)(ii)).

38. However, while different interests that are each "land" in their own right may be acquired at different times, what is relevant is the date **the land that is disposed of**, and potentially subject to tax under one of the land provisions in subpart CB, was acquired. For example, if someone is disposing of a freehold estate in fee simple and the date of acquisition is relevant to a particular taxing provision, the question is – when did they acquire *that land* (ie, the freehold estate)? Any other interest they have had in the land (for example, a leasehold interest) is not relevant.

The general rule

39. The general rule about when land is acquired for the purposes of the land provisions (except the 2-year bright-line test – discussed from [27]) is set out in s CB 15B(1), which says:

> **CB 15B When land acquired**
>
> *General rule*
>
> (1) For the purposes of this subpart except section CB 6A, a person acquires an estate, interest, or option that is land (the **land**) on the date that begins a period in which the person has an estate or interest in, or an option to acquire, the land, alone or jointly or in common with another person.

40. Under this general rule, a person acquires land on the date that they first have an estate or interest in the land, or first have an option to acquire the land. When land is acquired, different interests will typically arise at different times, and then ultimately merge when the full title is conferred. The fact that s CB 15B refers to the date that "begins a period" in which the person has an estate or interest in the land, or an option to acquire it, indicates that it is the **first** estate or interest in the land in question that is relevant.

41. As the High Court noted in *AAA Developments (Ormiston) Ltd v CIR* (2015) 27 NZTC 22,026 (HC), under s CB 15B a person is treated as acquiring land at the stage in the process of acquisition when they have a right or an interest in the land and are entitled to apply to a court for protection of that right.

When does someone first have an estate or interest in land under a sale and purchase agreement?

42. The legislation does not specify when someone is considered to first have an estate or interest in land. However, in *Bevin v Smith* [1994] 3 NZLR 648 (CA) it was held that a purchaser has an equitable interest in land from the time a binding contract exists, even if it is conditional. This is when equitable remedies are available to protect the purchaser's rights under the contract, though specific performance in the strict sense (ie, for the transfer of title) would not yet be available.

43. The most common conditions in contracts for the sale and purchase of land (such as the need to obtain finance, a building report or a LIM) would not prevent there being a binding contract. But sometimes conditions that will mean that there is not in fact a binding contract yet, so the land is not considered to be acquired yet. For example, there may not be a binding contract if a condition requires the approval of a company's directors or requires due diligence to be carried out. It is necessary to consider the terms of the particular contract and the nature of the conditions to determine whether there is a binding contract (see, for example, *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433 (CA), *Willetts v Ryan* [1968] NZLR 863 (CA), and *Barrett v IBC International Ltd* [1995] 3 NZLR 170 (CA)).

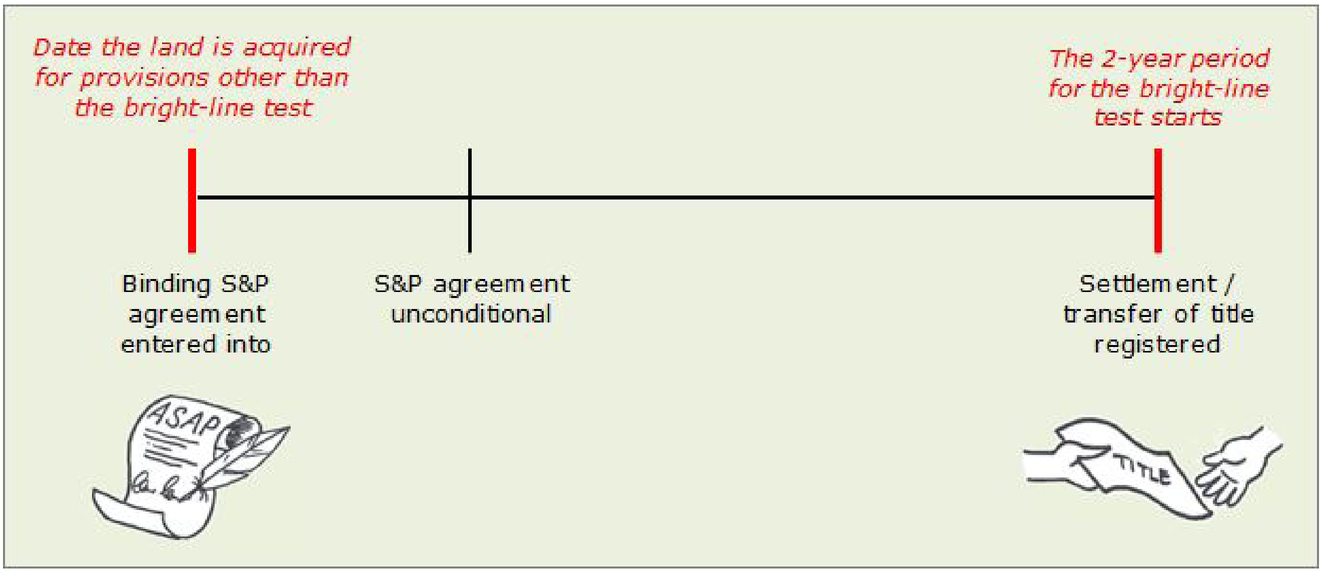
44. As noted at [40], the date a person acquires land under s CB 15B is the date they first have an estate or interest in the land, or an option to acquire the land. **In a typical land purchase, this will be the time at which a binding contract to purchase the land is formed (even if some conditions still need to be met)**.

45. This is supported by the extrinsic materials from the time of the introduction of s CB 15B. Those materials make it clear that a person is regarded as acquiring land at the time a binding agreement for the acquisition is formed, even if there are conditions that still need to be fulfilled. See, for example, *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill: Commentary on the Bill* (Inland Revenue, Wellington, November 2013).

46. What is relevant is the time that the person acquires the first interest in **the land in question** – ie, the land they are disposing of and is potentially subject to tax under one of the provisions in subpart CB. Other interests in the same underlying physical land will not be relevant. For example, if the sale of a freehold estate may give rise to taxation and the date of acquisition is relevant, the fact that the person previously had a leasehold interest in the land will not be relevant. The date on which their first interest in the freehold estate arose will be the date that land was acquired.

47. The following two examples illustrate when land is acquired under the general rule in s CB 15B(1). They also note when the 2-year period for the bright-line test starts.

Example 1 – Binding sale and purchase (S&P) agreement



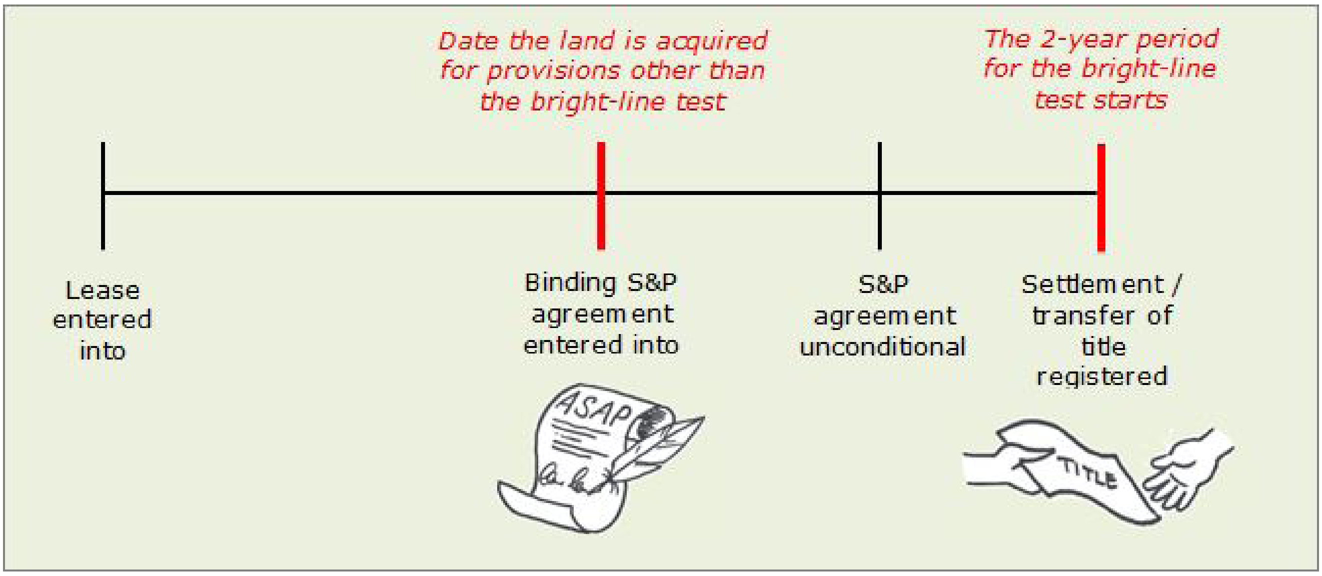
Sally entered into a sale and purchase agreement to purchase some land (the freehold estate). The agreement was subject to Sally obtaining satisfactory LIM and building reports within a specified timeframe. Those conditions were fulfilled, and the sale was settled in due course. When Sally sold the property some time later, one of the land provisions in subpart CB potentially applied and the date that she acquired the land was relevant.

For the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Sally acquired the land when she and the vendor entered into the binding sale and purchase agreement, even though that agreement was subject to conditions, because that was when Sally first had an equitable interest in the land.

Because Sally first got an estate or interest in the land when she and the vendor entered into the binding sale and purchase agreement, that is also the relevant date for determining if the bright-line legislation potentially applies. If the agreement was entered into on or after 1 October 2015, the bright-line legislation can apply to Sally's disposal of the land if none of ss CB 6 to CB 12 apply.

The 2-year period for the bright-line test (which may apply if none of ss CB 6 to CB 12 apply) starts on the date the transfer of title was registered to Sally.

Example 2 – Lease before acquisition of freehold



Tony and Cleo were renting a house that the owner decided to sell. Before putting the property on the market, the owner asked Tony and Cleo if they were interested in purchasing the property. They were, so entered into a sale and purchase agreement for the property. The agreement was subject to finance. That condition was fulfilled, and the sale was settled in due course.

When Tony and Cleo sold the property some time later, one of the land provisions in subpart CB potentially applied and the date that they acquired the land (the freehold estate) was relevant.

For the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Tony and Cleo acquired the land (the freehold) when they and the vendor entered into the binding sale and purchase agreement, even though it was subject to finance, because that was when Tony and Cleo first had an equitable interest in the land. It is not relevant that they previously held another interest in the underlying physical land (ie, the leasehold interest). The potential taxing event was the disposal of the freehold estate, so the issue is when the freehold estate was acquired.

Because Tony and Cleo first got an estate or interest in the land (the freehold) when they and the vendor entered into the binding sale and purchase agreement, that is also the relevant date for determining if the bright-line legislation potentially applies. If the agreement was entered into on or after 1 October 2015, the bright-line legislation can apply to Tony and Cleo's disposal of the land if none of ss CB 6 to CB 12 apply.

The 2-year period for the bright-line test (which may apply if none of ss CB 6 to CB 12 apply) starts on the date the transfer of title was registered to Tony and Cleo.

Nominations, assignments of contractual rights, and novations of contracts – what is the difference, how do these arrangements affect determining the date of acquisition, and are there bright-line implications for these arrangements?

48. One nomination situation that can arise is where the named purchaser is acting on someone else's behalf, and that person is subsequently nominated as the purchaser.

49. Another nomination situation that often occurs is where someone enters into a binding sale and purchase agreement to purchase land and that person "and/or nominee" are named as the purchaser. Before settlement, the person may then choose to nominate someone else (a nominee) to complete the purchase. A common situation where this occurs is where, after entering into the sale and purchase agreement, the purchasers decide to hold the property in a trust or other entity.

50. In this type of nomination situation, the nominee is able to enforce the contract through ss 4 and 8 of the Contracts (Privity) Act 1982,[3] but the original contracting party (the nominator) remains a party to the contract and may also enforce its terms.

51. It may also be that the named purchaser assigns their rights under the sale and purchase agreement to someone else. If there is an assignment of contractual rights, the assignor *transfers* their rights to the assignee, who is then entitled to the benefit of the contract and can enforce those rights against the other party to the contract.

52. There will be an assignment of the contractual rights under a sale and purchase agreement to purchase land if there is a deed or other signed document that shows that the intention is that the original named purchaser is transferring all of their rights under the sale and purchase agreement to the other person – whether absolutely, conditionally, or by way of charge. A common situation where there is an assignment of contractual rights is where someone purchases land off the plans and then on-sells it before settlement. Note that the document does not need to purport to be an assignment to be one. It may be that a document that is described as a nomination in fact amounts to an assignment of the contractual rights. That said, someone simply nominating a different person or entity as the purchaser would not inadvertently effect an assignment of the contractual rights, given the nature of the wording that would need to be used for there to be an assignment.

53. It is also possible for there to be a novation, in which case the original contract is discharged, and a new contract with a different purchaser entered into. This requires the vendor to consent to both the cancellation of the original contract and the creation of the new contract. Consent may be inferred from the behaviour of the vendor, but a normal nomination situation is unlikely to be regarded as a novation. See, for example, *Karangahape Road International Village Ltd v Holloway* [1989] 1 NZLR 83 (HC) and *Stonne Ltd v Ronyx Holdings Ltd* (2005) 7 NZCPR 18 (HC).

Nominations

54. In the nomination situation where the named purchaser is acting on someone else's behalf and that person is subsequently nominated as the purchaser, a special provision (s YB 21) will apply. Under that provision, because the named purchaser was acting on the other person's behalf, the other person is treated as having done what the named purchaser did (ie, enter into the contract), and holding the resulting rights. The person acting on the other's behalf is ignored. Because of this, the person who the nominee is acting for will be treated as having acquired the land at the time the nominee first had an estate or interest in the land. In a standard purchase of land situation this will be when there is a binding contract between the vendor and the nominee to purchase the land.

[3] See for example, *Rattrays Wholesale Ltd v Meredyth-Young & A'Court* [1997] 2 NZLR 363 (HC) and *Laidlaw v Parsonage* [2010] 1 NZLR 286 (CA).

55. As noted at [49], the other type of nomination situation is where the named purchaser is not acting on someone else's behalf, but before settlement they nominate someone else to complete the purchase. In that situation, the nominee acquires the land under s CB 15B (relevant for the land provisions in subpart CB except the 2-year bright-line test) on the date they are nominated as the purchaser. This is when the nominee first has an equitable interest in the land. This is because the nominee is able to enforce the contract through ss 4 and 8 of the Contracts (Privity) Act 1982. While the original named purchaser remains a party to the contract, and may also enforce its terms (in addition to remaining liable for the performance of the burden of their promises under the contract), the nomination gives the nominee an equitable interest in the land too.[4]

56. Usually, in this type of nominee situation, the nominator and nominee are associated. Where land is transferred between associated persons, s CB 15(2) alters the date of acquisition for the transferee for the purposes of most of the land provisions (ss CB 7 to CB 12, and s CB 14). Section CB 15(2) treats the transferee as having acquired the land on the date on which the transferor acquired it. However, s CB 15(2) will not apply to alter the date of acquisition for a nominee who is associated with the original named purchaser who nominated them. This is because the original named purchaser does not *transfer* their interest in the land to the nominee when they make the nomination. As noted at [50], they continue to have their rights under the contract and, therefore, their interest in the land. The nomination simply creates additional rights (for the nominee).

57. The nominee's date of acquisition is, therefore, established under the general rule in s CB 15B(1). As noted at [55], this will be the date they are nominated as the purchaser.

58. The 2-year period for the bright-line test would start for the nominee on the date the transfer of title is registered to them (which typically happens on the settlement date). If there is no registered transfer of the land to the nominee on or before the date they sell or dispose of the land, the 2-year period will start on the date they were nominated as purchaser.

59. The nomination of someone else as purchaser will not give rise to any potential bright-line implications for the nominator (the original named purchaser). This is because, as noted above, the nominator does not transfer their interest in the land to the nominee when they make the nomination – there is no disposal. When the legal title transfers to the nominee (typically on the settlement date), the nominator's interest in the land simply ceases to exist, it is not disposed of. This is somewhat analogous to the lapsing of an option to acquire land, which has been considered by the Taxation Review Authority not to be a disposition of land (*Case M4* (1990) 12 NZTC 2,021 (TRA)).

60. The item "Taxation (Bright-line Test for Residential Land) Act 2015" *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78 included an example (at 82) showing how s CB 6A applies in a nominee situation. That example stated that a nomination was a disposal, so s CB 6A could apply to tax any increase in the value of the property. This QWBA supersedes the *Tax Information Bulletin* item in this respect.

Assignment of contractual rights

61. If what has occurred is an assignment of contractual rights (see [51] – [52]) and the parties are not associated, the assignee acquires the land under s CB 15B (so for the land provisions in subpart CB except the 2-year bright-line test) on the date of the assignment. This is when the assignee first has an equitable interest in the land.

62. If the assignor and assignee are associated, the assignee's date of acquisition for the purposes of most of the land provisions (ss CB 7 to CB 12, and s CB 14) will be the date that the assignor first had their equitable interest in the land (ie, typically, the date they entered into the contract to purchase the land, even if some conditions still needed to be met).

63. This is because s CB 15(2) treats someone who acquires land from an associated person as having acquired it on the date the associated person did. That means that the assignee is treated as having acquired the equitable interest in the land that the assignor had at the date the assignor acquired it. If the assignee's subsequent disposal of the estate in fee simple is potentially subject to tax and the date they acquired the land is relevant, the question in terms of s CB 15B is when did they first acquire an estate or interest in that land. Because they were associated with the assignor, so are treated as having acquired the equitable interest at the time the assignor did, they first had an interest in the estate in fee simple from that time.

64. The 2-year period for the bright-line test would start for the assignee on the date the transfer of title is registered to them (which typically happens on the settlement date).

65. If the land is residential land, the assignment of the contractual rights to someone else within two years of the sale and purchase agreement being entered into may mean any amount the assignor derives on the disposal (the assignment of the rights) is taxed under the bright-line test (if none of ss CB 6 to CB 12 apply).

[4] *Rivette v Atrax Group New Zealand Ltd* (2010) 11 NZCPR 723 (HC).

66. If there is no amount paid for the assignment (or if the consideration is less than market value), the assignor would be treated as having derived an amount equal to the market value of the land that is disposed of (the equitable interest). The assignee would similarly be treated as having incurred expenditure of an amount equal to the market value of the land (the equitable interest).

67. The deeming of a market value amount being derived by the assignor and incurred by the assignee is because of s GC 1, which deals with disposals of trading stock at below market value. Section GC 1 would apply because the land is "trading stock" (as defined in s YA 1) for the purposes of s GC 1. For s GC 1 purposes, "trading stock" includes land, if the disposal of the land would produce income under any of the land provisions (including the bright-line test). Because the assignment of the contractual rights is within two years, it is a disposal of land that would produce income under the bright-line test, so the land is trading stock.

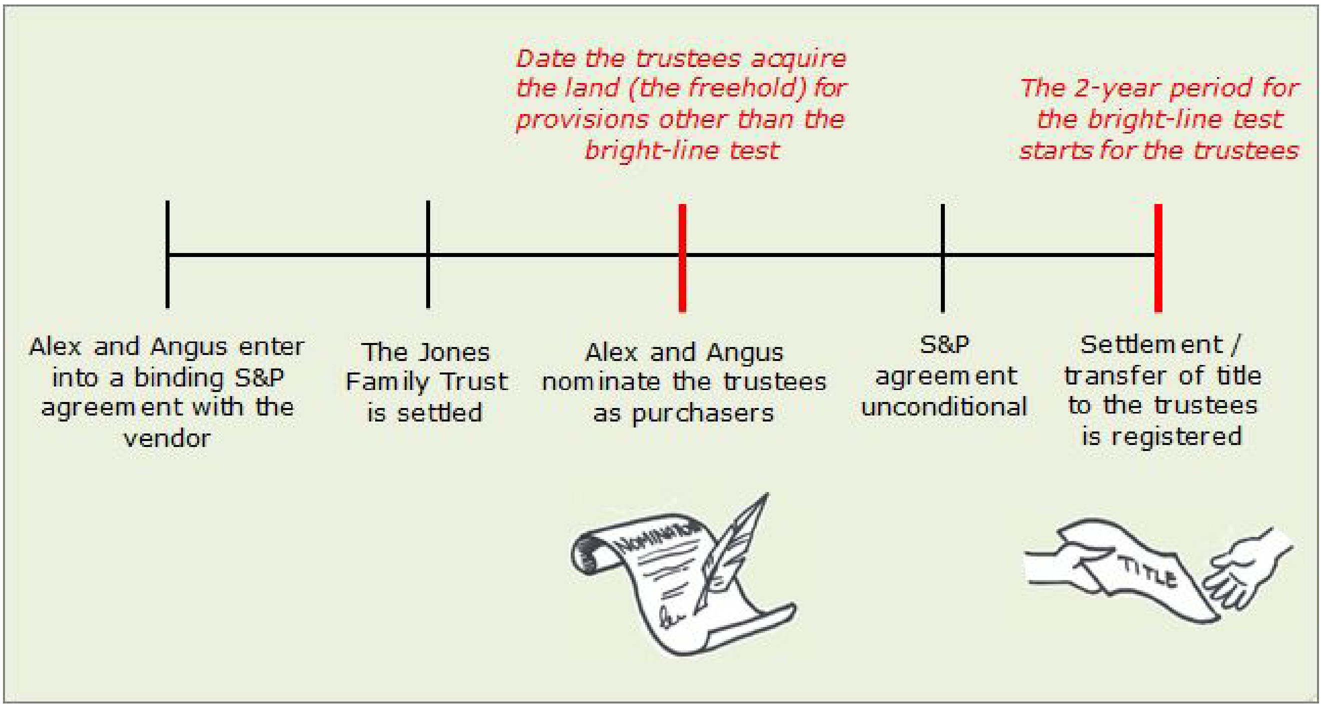
68. This deeming of a market value amount being derived by the assignor and incurred by the assignee means that even if there is no consideration for the assignment, there will be tax implications under s CB 6A if the market value of the land changes between the time an original named purchaser enters into the sale and purchase agreement and the time they assign their rights under that contract to someone else. It is important to bear in mind that as with any other sale or disposal of land, there may be residential land withholding tax obligations if the assignor is an "offshore RLWT person" (defined in s YA 1).

Novation of the contract

69. If what has occurred is a novation of the contract (see [53]), there will be no implications under the land sale rules for the original purchaser. This is because their interest in the land is not disposed of; it simply ceases to exist when the original contract is discharged. The purchaser under the new contract will acquire the land under the rules discussed in this QWBA, and their bright-line start date will be established as discussed in this QWBA.

70. The following two examples illustrate when land is acquired under s CB 15B where there is a nomination, and when there is an assignment of contractual rights. They also note when the 2-year period for the bright-line test starts.

Example 3 – Acquisition of land where there is a nominee



Alex and Angus entered into a sale and purchase agreement to buy a property they thought would be a great investment. They planned to hold the property in a trust, but had not yet settled a trust when they found the property they wanted to buy. The sale and purchase agreement named "Alex and Angus and/or nominee" as the purchaser. Alex and Angus subsequently settled a trust (the Jones Family Trust), and advised the vendor that they nominated the trustees of the Jones Family Trust to be the purchasers and take title at settlement. The sale and purchase agreement subsequently went unconditional when a satisfactory building report and LIM were obtained. The sale was concluded, and the title was registered in the names of the trustees of the trust. When the Jones Family Trust sold the property some years later, one of the land provisions in subpart CB potentially applied and the date that the trustees of the trust acquired the land was relevant.

For the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, the trustees of the Jones Family Trust acquired the land on the date Alex and Angus nominated the trustees as the purchasers. This was when they first had an equitable interest in the land.

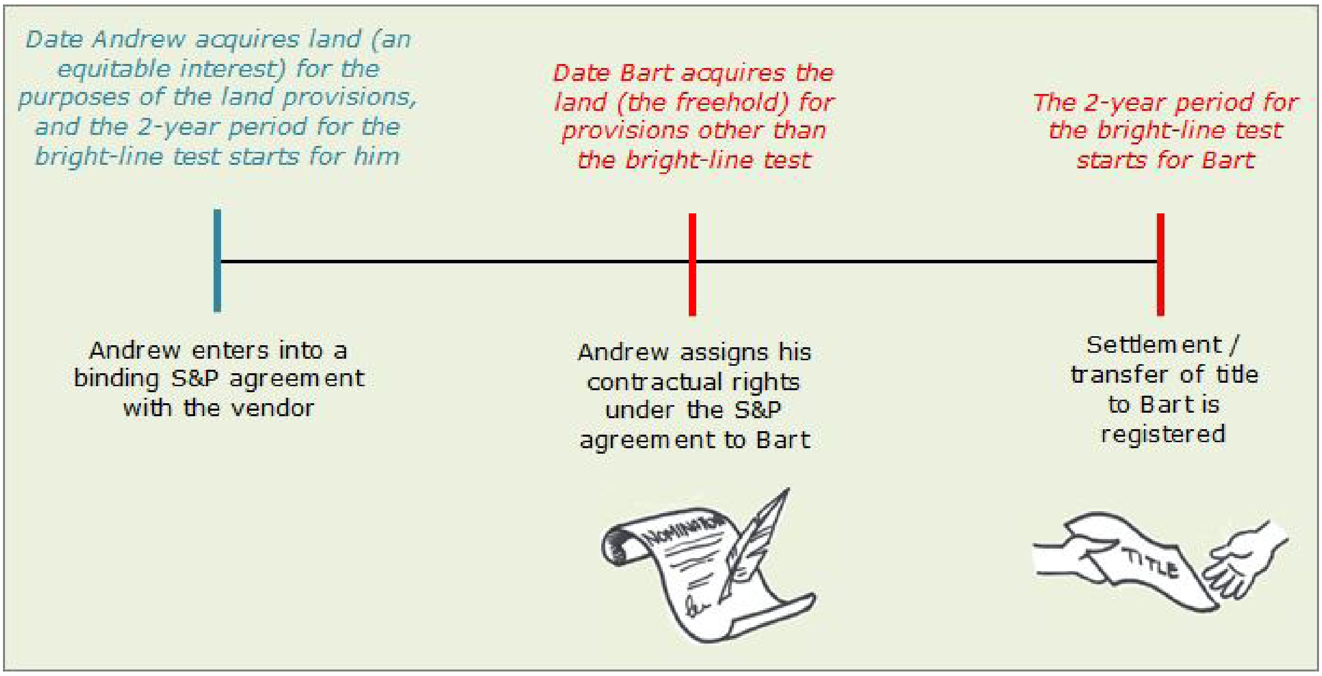
Alex and Angus are each associated with the trustees of the trust, because they are settlors of the trust (see s YB 8). But s CB 15(2) does not apply in this case to treat the trustees of the Jones Family Trust as having acquired the land when Alex and Angus did. This is because the nomination did not give rise to a transfer of land from Alex and Angus to the trustees. Alex and Angus continued to hold their rights under the contract, and therefore their interest in the land. The nomination simply created additional rights (for the trustees).

Because the trustees of the Jones Family Trust first got an estate or interest in the land when Alex and Angus nominated them as the purchasers, that is also the relevant date for determining if the bright-line legislation potentially applies. If the nomination was on or after 1 October 2015, the bright-line legislation can apply to the trust's disposal of the land if none of ss CB 6 to CB 12 apply.

For the trust, the 2-year period for the bright-line test (which may apply if none of ss CB 6 to CB 12 apply) starts on the date the transfer of title was registered to the trustees.

The nomination of the trustees as purchaser will not give rise to any tax implications under the land rules for Alex and Angus. This is because, as noted above, Alex and Angus did not transfer their interest in the land to the trustees when they made the nomination – there was no disposal. On settlement, when the legal title transferred to the trustees, Alex and Angus's interest in the land simply ceased to exist, it was not disposed of.

Example 4 – Acquisition of land where there is an assignment of contractual rights to purchase the land



Andrew entered into a sale and purchase agreement to buy a house, and paid a deposit of $60,000. Andrew subsequently received an unsolicited offer from a non-associated party, Bart, to buy the property. Andrew agreed to the sale and, as settlement had not yet occurred, Andrew and Bart decided that Andrew would assign his rights under the sale and purchase agreement to Bart in exchange for a fee of $110,000. This was recorded in a deed, which was signed two months after Andrew entered into the sale and purchase agreement with the vendor. The deed was entitled "Deed of Nomination", but it was clear from the words of the deed that the intention was that Andrew was transferring all of his rights under the sale and purchase agreement to Bart. Therefore, the transaction was an assignment of the contractual rights, not a nomination. The label the parties put on the document does not determine its legal effect. The sale was concluded with Bart as the purchaser. When Bart sold the property some years later, one of the land provisions in subpart CB potentially applied and the date that he had acquired the land was relevant.

For the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Bart acquired the land on the date the deed that assigned the contractual rights to him was executed. This was when Bart first had an equitable interest in the land.

Because Bart first got an estate or interest in the land when the deed that assigned the contractual rights to him was executed, that is also the relevant date for determining if the bright-line legislation potentially applies. If the assignment of the contractual rights was on or after 1 October 2015, the bright-line legislation can apply to Bart's disposal of the land if none of ss CB 6 to CB 12 apply.

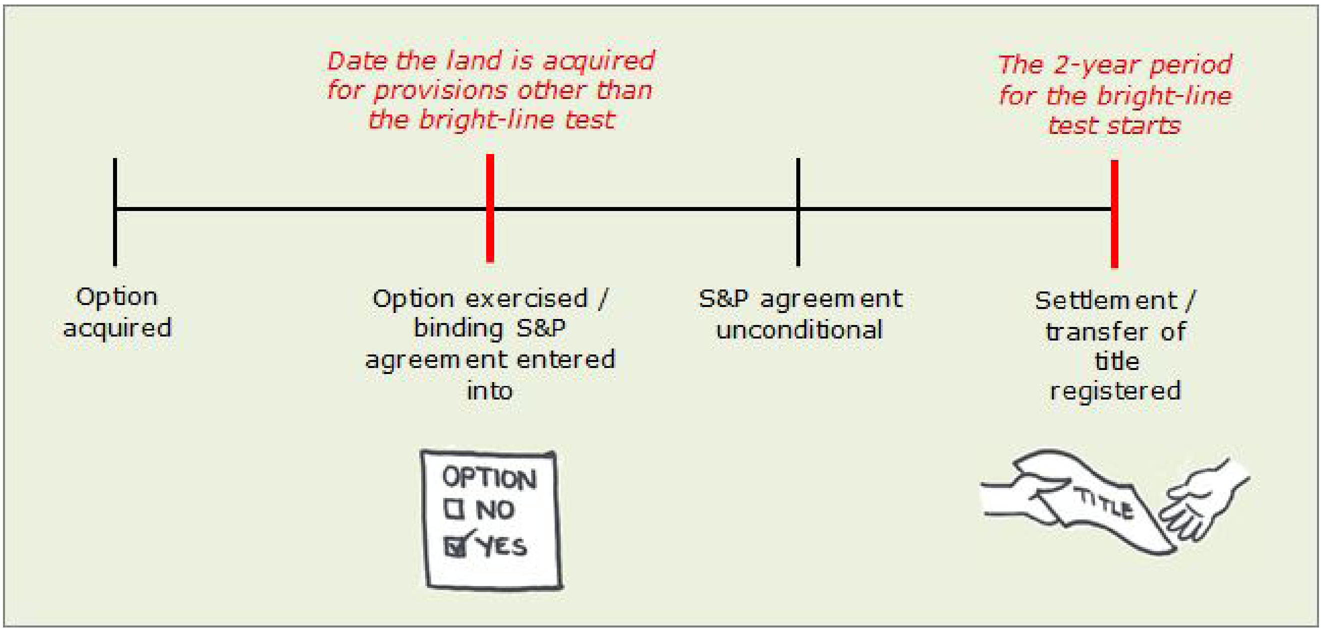
For Bart, the 2-year period for the bright-line test (which may apply if none of ss CB 6 to CB 12 apply) starts on the date the transfer of title was registered to him.

When Andrew entered into the sale and purchase agreement to buy the house, he acquired an equitable interest in the land (which is "land" as defined). If that was on or after 1 October 2015, the bright-line legislation could apply to Andrew's disposal of his rights under the sale and purchase agreement to Bart, if none of ss CB 6 to CB 12 apply. When Andrew assigned the rights under the contract to Bart, he transferred his equitable interest to Bart. Because Andrew entered into an agreement to dispose of land before the registration of title, his start date for the bright-line test is the date he acquired the equitable interest – ie, the date the sale and purchase agreement was entered into. Because the land is residential land, and the assignment of the contractual rights to Bart was within two years of the sale and purchase agreement being entered into, the amount Andrew derived on the disposal ($110,000) is income under the bright-line test in s CB 6A (if Andrew entered into the sale and purchase agreement on or after 1 October 2015 and if none of ss CB 6 to CB 12 apply). The main home exclusion from the bright-line test (in s CB 16A) cannot apply because Andrew never lived in the house. Andrew would be able to deduct the cost of his acquisition of the equitable interest (ie, the amount of the deposit he paid, $60,000).

What if someone acquires land by way of an option?

71. A special rule (s CB 15B(3)) applies if someone acquires land through the exercise of an option to acquire it.
72. An option to acquire land might be a right contained within a lease, or it might be granted separately. An option is essentially an offer to sell, together with a contract not to revoke the offer (see, for example, *Alexander v Tse* [1988] 1 NZLR 318 (CA), and DW McMorland, *Sale of Land* (3rd ed, Cathcart Trust, Auckland, 2011) at 3.16).
73. Someone may also be granted what is known as a pre-emptive right or "first right option" to acquire land – eg, a right of first refusal or a right of first offer. Although these pre-emptive rights are not, strictly speaking, options, if someone acquires the land through the exercise of such a right, it will have become an option by that point. This means the special rule about acquiring land through the exercise of an option will also apply if someone acquires the land through the exercise of a pre-emptive right.
74. Under the special rule for land acquired through the exercise of an option, the person is regarded as acquiring the land **on the date that they exercised the option**. As noted above, what is relevant is when they acquired the land in question (ie, the land they are disposing of). It is not relevant if they previously had a different interest in the same underlying physical land. For example, if a person had a leasehold interest in the land and an option to acquire the freehold, and they exercise the option, acquire the freehold and subsequently dispose of it, what is relevant is when they acquired the freehold. In that situation it would be the date that they exercised the option. Their prior leasehold interest is not relevant.
75. Another thing to note is that an option to acquire land (or an estate or interest in land) is also itself "land" as defined in the Act. Therefore, if someone disposes of an option to acquire land, the date the option was acquired may be relevant. On this point, see from [78].
76. The following four examples illustrate when land is acquired under s CB 15B where an option or "first right option" is involved. They also note when the 2-year period for the bright-line test starts.

Example 5 – Option to purchase land



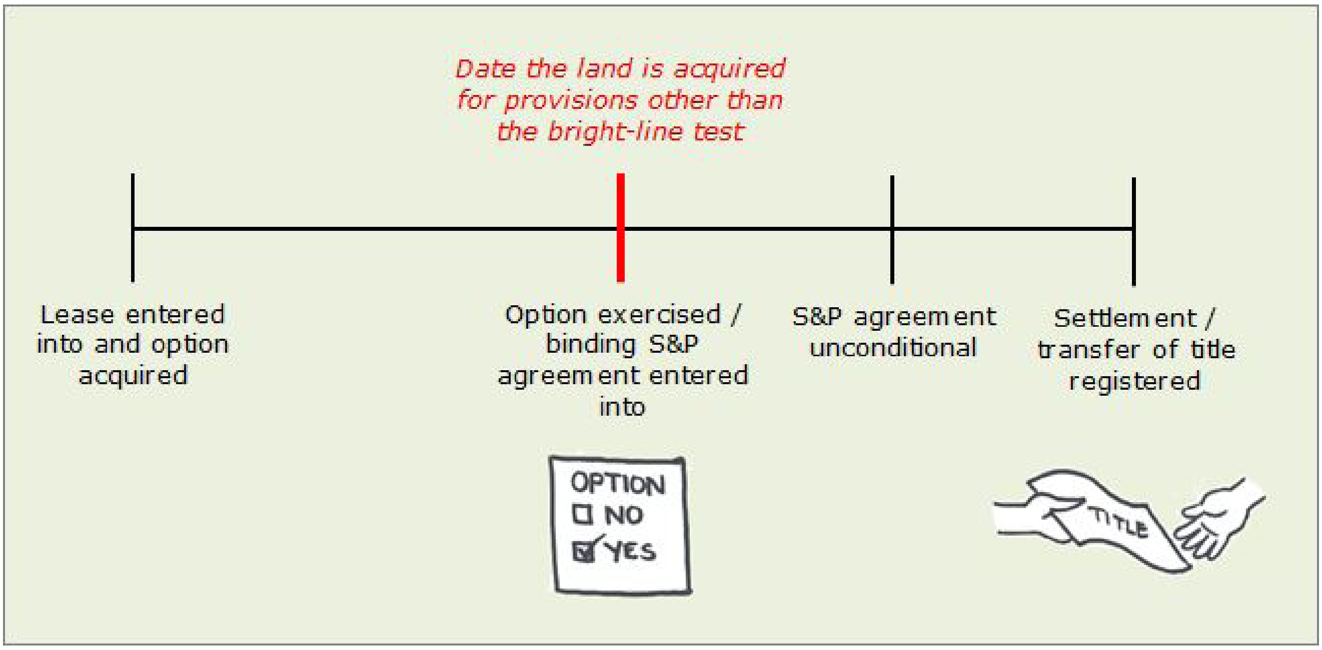
Sanjay purchased an option to buy some land for a specified sum. Sanjay exercised the option. By doing so, a binding contract for the sale and purchase of the land was created on the terms set out in the option contract. The sale was settled in due course. When Sanjay went to sell the land several years later, one of the land provisions in subpart CB potentially applied and the date that Sanjay had acquired the land (the freehold estate) was relevant.

Because Sanjay acquired the freehold through the exercise of the option, the exception to the general rule (contained in s CB 15B(3)) applies. Under the special rule in s CB 15B(3), for the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Sanjay acquired the land (the freehold) when he exercised the option.

However, because Sanjay first got an estate or interest in the land when he acquired the option, that is the relevant date for determining if the bright-line legislation potentially applies. If Sanjay acquired the option on or after 1 October 2015, the bright-line legislation can apply to Sanjay's disposal of the land if none of ss CB 6 to CB 12 apply.

The 2-year period for the bright-line test (which may apply if none of ss CB 6 to CB 12 apply) starts on the date the transfer of title was registered to Sanjay.

Example 6 – Lease with option to purchase land



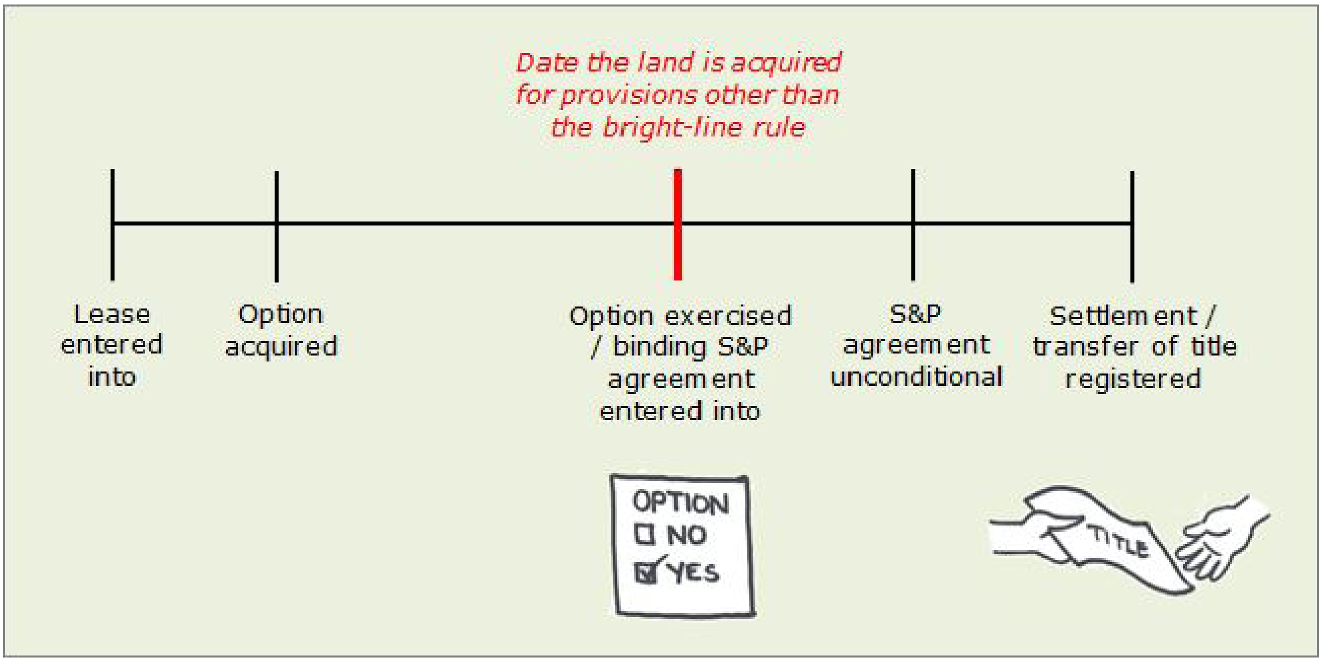
Baymax Robotics Limited entered into a lease of business premises and at the same time acquired an option, exercisable within the next two years, to buy the premises for a specified sum. Baymax Robotics exercised the option. By doing so, a binding contract for the sale and purchase of the land was created on the terms set out in the option contract. The sale was settled in due course. Baymax Robotics used the land predominantly as business premises. When Baymax Robotics went to sell the premises, one of the land provisions in subpart CB potentially applied and the date that Baymax Robotics had acquired the land (the freehold estate) was relevant.

Because Baymax Robotics acquired the freehold through the exercise of the option, the exception to the general rule (contained in s CB 15B(3)) applies. Under the special rule in s CB 15B(3), for the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Baymax Robotics acquired the land (the freehold) when it exercised the option.

However, because Baymax Robotics first got an estate or interest in the land when it acquired the option, that is the relevant date for determining if the bright-line legislation potentially applies. If Baymax Robotics acquired the option on or after 1 October 2015, the bright-line legislation can apply to Baymax Robotics' disposal of the land if none of ss CB 6 to CB 12 apply.

Because Baymax Robotics used the land predominantly as business premises, the 2-year bright-line test would not apply to the sale, as the land would not be "residential land" as defined in the Act.

Example 7 – Lease and subsequent option to purchase land



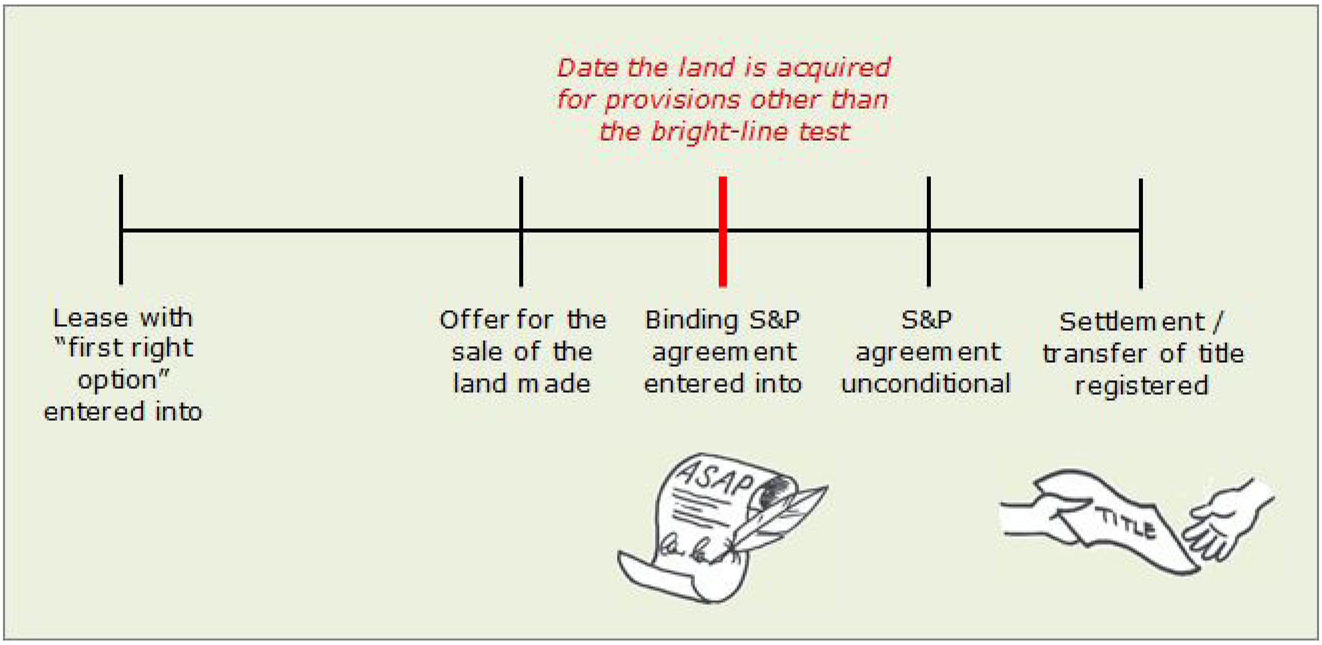
Scissorhands Sculpting Limited was leasing some land from which it operated its business. As the business became increasingly successful, Scissorhands Sculpting wanted to lock in the ability to purchase the land if things continued to go well. Scissorhands Sculpting entered into negotiations with the owner and, as a result, acquired an option, exercisable within a set period, to buy the land for an agreed sum. Scissorhands Sculpting exercised the option. By doing so, a binding contract for the sale and purchase of the land was created on the terms set out in the option contract. The sale was settled in due course. Scissorhands Sculpting used the land predominantly as business premises. When Scissorhands Sculpting went to sell the land, one of the land provisions in subpart CB potentially applied and the date that Scissorhands Sculpting had acquired the land (the freehold estate) was relevant.

Because Scissorhands Sculpting acquired the freehold through the exercise of the option, the exception to the general rule (contained in s CB 15B(3)) applies. Under the special rule in s CB 15B(3), for the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Scissorhands Sculpting acquired the land (the freehold) when it exercised the option. It is not relevant that the company previously held another interest in the underlying physical land (ie, the leasehold interest). The potential taxing event was the disposal of the freehold estate, so the issue is when the freehold estate was acquired.

However, Scissorhands Sculpting first got an estate or interest in the freehold land when it acquired the option. That is therefore the relevant date for determining if the bright-line legislation potentially applies. If Scissorhands Sculpting acquired the option on or after 1 October 2015, the bright-line legislation can apply to Scissorhands Sculpting's disposal of the land if none of ss CB 6 to CB 12 apply.

Because Scissorhands Sculpting used the land predominantly as business premises, the 2-year bright-line test would not apply to the sale, as the land would not be "residential land" as defined in the Act.

Example 8 – Lease with "first right option" to purchase land



Jimmy Chews Limited leased its restaurant premises and had a "first right option" (a right of first refusal) to purchase the land in the event the owner decided to sell it. As it transpired, the owner decided to sell the land during the term of the lease. The owner made an offer to Jimmy Chews, which Jimmy Chews accepted, and the parties entered into a sale and purchase agreement. The sale and purchase agreement was subject to finance and to the obtaining of satisfactory building and LIM reports. Those conditions were fulfilled, and the sale was settled in due course. Jimmy Chews used the land predominantly as business premises. When Jimmy Chews went to sell the land, one of the land provisions in subpart CB potentially applied and the date that Jimmy Chews acquired the land (the freehold estate) was relevant.

When the previous owner made an offer to Jimmy Chews, the "first right option" became an option to acquire the freehold. Because Jimmy Chews acquired the freehold through the exercise of that option, the exception to the general rule (contained in s CB 15B(3)) applies. Under the special rule in s CB 15B(3), for the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, Jimmy Chews acquired the land (the freehold) when it exercised the option by accepting the offer and entering into the binding contract for the sale and purchase of the land. It is not relevant that Jimmy Chews previously held another interest in the underlying physical land (ie, the leasehold interest). The potential taxing event was the disposal of the freehold estate, so the issue is when the freehold estate was acquired.

However, Jimmy Chews first got an interest in the freehold land when the offer was made to him (as this is when Jimmy Chews had the option to acquire the land).[5] That is therefore the relevant date for determining if the bright-line legislation potentially applies. If the offer was made to Jimmy Chews on or after 1 October 2015, the bright-line legislation can apply to Jimmy Chews' disposal of the land if none of ss CB 6 to CB 12 apply.

Because Jimmy Chews used the land predominantly as business premises, the 2-year bright-line test would not apply to the sale, as the land would not be "residential land" as defined in the Act.

Subdivided land

77. If someone subdivides land, a new title might be issued. This does not reset the person's date of acquisition of the land. Their date of acquisition for the new land will be whatever date they acquired the original undivided piece of land. (See for example Paul Stephens Construction Ltd v CIR (1990) 12 NZTC 7,192 (HC).)

Acquisition of an option

78. As noted at [19], an option to acquire land or an estate or interest in land also falls within the definition of "land" in the Act.

79. Because options to acquire land or estates or interests in land are "land", if someone disposes of an option to another party rather than exercising it, the amount they derive on disposing of the option may be income under one of the land provisions in subpart CB. Depending on which taxing provision is potentially relevant, the time at which the person acquired the option may be relevant.

[5] As discussed at [25], this is typically the case in a "first right option" situation. See further *Motor Works Ltd v Westminster Auto Services Ltd*.

80. Under s CB 15B, an option will be acquired when a binding agreement creating the option, or for the transfer of the option, is entered into. This is the time from which the holder or purchaser of the option has an interest in the option.

81. "Residential land", which the bright-line test may apply to, includes **land** with a dwelling on it (or for which the owner has an arrangement relating to erecting a dwelling). As already noted, "land" includes an option to acquire land or an estate or interest in land. These definitions mean that "residential land" will include an option to acquire land or an estate or interest in land that has a dwelling on it (or for which the owner has an arrangement relating to erecting a dwelling). Therefore, if an option to acquire residential land is disposed of within the bright-line period, s CB 6A may apply. Because there will be no registered instrument of transfer for an option, the date an option is acquired for bright-line purposes will also be the date that a binding agreement creating the option, or for the transfer of the option, is entered into.

82. The following example illustrates when an option to acquire land is acquired under s CB 15B, and when the 2-year period for the bright-line test starts for an option.

Example 9 – Acquisition of an option to purchase land

ABC Dealing Limited, which carries on a business of dealing in land, entered into an option contract under which it had the right to purchase some residential land within a specified period, for a specified price. ABC Dealing Limited decided to sell the option, and did so.

For the purposes of the land sale provisions in subpart CB, other than the 2-year bright-line test, ABC Dealing Limited acquired the land (the option) when the option contract was entered into. This is the time from which ABC Dealing Limited has an interest in the option. Because there was no registered transfer of land to ABC Dealing Limited, the 2-year period for the bright-line test also starts on the date the option contract was entered into.

Acquisition of land on behalf of a company to be formed

83. Section CB 15B(2) provides that if a person on behalf of a company to be formed enters into an agreement under which the company will have land, the company is treated, for the purposes of subpart CB in relation to the land, as existing from when the person enters into the agreement.

84. Because the company is deemed to exist at the time the relevant agreement is entered into and the person entered into the agreement on behalf of the company, the date that the person entered into the agreement (that gave rise to an interest in land) will be the date the company is treated as having acquired the land.

85. There are no bright-line test implications for a person who acquires land on behalf of a company yet to be formed where the company subsequently ratifies the contract for the acquisition of the land. This is because s 182 of the Companies Act 1993 allows for ratification of pre-incorporation contracts, and at common law an effective ratification constitutes the relationship of principal and agent retrospectively.[6] This means that the person who acquired the land on behalf of the company yet to be formed has not themselves acquired (and subsequently disposed of) a land interest.

When there may be a different date of acquisition rule

86. Note that the date of acquisition rules in s CB 15B are overridden, for a particular transaction, by any relevant provision in either subpart FB or subpart FC. Those subparts deal with transactions such as transfers on settlements of relationship property, distributions on death, distributions from a trust, transfers of value from a company, and gifts of property.

87. Also, for the purposes of certain provisions, a person may be treated as acquiring land at a different date than the date under s CB 15, if they acquire land on an amalgamation (s FO 17) or, as noted at [56], from an associated person (s CB 15(2)).

[6] See further in this regard: *Laws of New Zealand Agency* (online ed, accessed 28 March 2017) from [42].

References

Related rulings/statements

"Taxation (Bright-line Test for Residential Land) Act 2015" *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78

Subject references

Acquisition of land

Legislative references

Companies Act 1993, s 182

Contracts (Privity) Act 1982, ss 4 and 8

Income Tax Act 2007, ss CB 6A, CB 6, CB 7, CB 9, CB 10, CB 12, CB 14, CB 15, CB 15B, CB 16A, CB 19, FO 17, GC 1 and YB 21, subparts FB and FC, and the definitions of "estate" (in relation to land), "estate in land" "estate or interest in land", "interest" (in relation to land), "interest in land", "land", "offshore RLWT person" and "trading stock" in s YA 1

Land Transfer Act 1952

Taxation (Bright-line Test for Residential Land) Act 2015, s 4(2)

Case references

AAA Developments (Ormiston) Ltd v CIR (2015) 27 NZTC 22,026 (HC)

Alexander v Tse [1988] 1 NZLR 318 (CA)

Barrett v IBC International Ltd [1995] 3 NZLR 170 (CA)

Bevin v Smith [1994] 3 NZLR 648 (CA)

Case M4 (1990) 12 NZTC 2,021 (TRA)

Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd [2002] 2 NZLR 433 (CA)

Karangahape Road International Village Ltd v Holloway [1989] 1 NZLR 83 (HC)

Laidlaw v Parsonage [2010] 1 NZLR 286 (CA)

Motor Works Ltd v Westminster Auto Services Ltd [1997] 1 NZLR 762 (HC)

Paul Stephens Construction Ltd v CIR (1990) 12 NZTC 7,192 (HC)

Rattrays Wholesale Ltd v Meredyth-Young & A'Court [1997] 2 NZLR 363 (HC)

Rivette v Atrax Group New Zealand Ltd (2010) 11 NZCPR 723 (HC)

Stonne Ltd v Ronyx Holdings Ltd (2005) 7 NZCPR 18 (HC)

Willetts v Ryan **[1968] NZLR 863 (CA)**

Other references

Laws of New Zealand Agency (online ed, accessed 28 March 2017) from [42]

McMorland, DW, Sale of Land (3rd ed, Cathcart Trust, Auckland, 2011)

Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill: Commentary on the Bill (Inland Revenue, Wellington, November 2013)

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 2017/01– A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (Russell Investment Company plc: NZDH-A-DURH class shares).

Reference

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

Discussion (which does not form part of the determination)

Shares in the Russell Investment Company plc (RIC), an Irish public limited company to which this determination applies, are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors. RIC is structured as an umbrella fund with segregated liability between sub-funds. Those sub-funds do not have a separate legal personality under Irish law.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in RIC each year.

The Russell Global Bond Fund (RGBF) is a sub-fund of RIC which invests in a portfolio of transferable debt instruments. RIC issues a class of shares denominated in New Zealand dollars (NZDH-A-DURH shares) that provide holders of that class of shares with an interest in the pool of investments held by the RGBF. RIC undertakes hedging for NZDH-A-DURH shares, with the intention that this arrangement ensures that the New Zealand dollar value of that class of shares is unaffected by foreign exchange movements.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the fair dividend rate (FDR) method, but would apply if the RGBF represented a separate foreign company and the NZDH-A-DURH share class was the only class of shares on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement, including any interposed entities or financial arrangements, in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in NZDH-A-DURH shares issued by RIC and the share class, which has a value in New Zealand dollars, is linked to an interest in a pool of debt securities held by RGBF and effectively hedged against foreign currency movements by RIC, I consider that it is appropriate for those holdings in RIC to be excluded from using the FDR method for the 2017 and subsequent income years.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
    a. is an Irish public limited company established on 31 March 1994 that issues multiple classes of shares;
    b. is known at the date of this determination as Russell Investment Company plc; and
    c. is structured as an umbrella fund with segregated liability between sub-funds; and

2. The attributing interest consists of a New Zealand dollar denominated class of shares, NZDH-A-DURH, issued by that non-resident that provides exposure solely to a sub-fund that predominantly (i.e. 80% or more by value at a time in the income year) holds transferrable debt instruments and
3. The investment assets attributable to NZDH-A-DURH shares are subject to foreign currency hedging arrangements undertaken by the non-resident for the purpose of eliminating any exchange rate risk for New Zealand investors.

Interpretation

In this determination unless the context otherwise requires:

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

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Act; and

"The Act" means the Income Tax Act 2007.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2017 income year and subsequent income years. However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination also applies for an income year beginning before the date of this determination for a person who invests in NZDH-A-DURH shares in RIC and who chooses that this determination applies for that income year.

Dated this 17th day of March 2017.

Graham Poppelwell
Investigations Manager

Special Determination S52: Valuation of Shares Issued by Bank following a Non-Viabilty Trigger Event

This Determination may be cited as Special Determination S52: Valuation of Shares Issued by Bank following a Non-Viability Trigger Event

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 wholesale investors pursuant to a Deed Poll. The Notes will contain a conversion mechanism, whereby the Bank will immediately and irrevocably convert Notes into ordinary shares in Bank upon the occurrence of a Non-Viability Trigger Event, in order to allow them to be recognised as Tier 2 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 17/17 issued on 20 March 2017, 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 wholesale investors pursuant to a Deed Poll. The Deed Poll will set out the steps that will occur upon Conversion following a Non-Viability Trigger Event.

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

(a) On the Conversion Date, Bank will issue a specified “conversion number” of Bank ordinary shares to each Holder in respect of each Note to be Converted.

(b) Each Note will be immediately redeemed by Bank for an amount equal to the NZ$ equivalent of the A$ Face Value of the Note. Under the terms of the Deed Poll, the NZ$ equivalent of the A$ Face Value owed to each Holder will be repaid by being applied on each Holder’s behalf to subscribe for the relevant "conversion number" of ordinary shares in Bank.

3.3 This determination applies when shares are issued by Bank to each Holder on Conversion to determine the value of the shares issued by Bank 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 the Deed Poll 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.
- **Conversion, Non-Viability Trigger Event** and **Face Value** have the same meaning as described in private ruling BR Prv 17/17, issued on 20 March 2017.
- **Notes** means the Subordinated Notes issued to wholesale investors pursuant to a Deed Poll.

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 Holders 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 A$100 to Holders. Following a Non-Viability Trigger Event, Notes having a Face Value of A$100 are converted into ordinary shares in Bank. Bank immediately repays the NZ$ equivalent of the A$ Face Value of the Notes and applies the relevant amount on each Holder's behalf to subscribe for ordinary shares in Bank. Bank issues the number of shares to each Holder calculated in accordance with the "conversion number" formula in the Deed Poll. The value of the aggregate shares issued, for the purposes of s EW 32, is the NZ$ equivalent of A$100.

This Determination is signed by me on the 20th day of March 2017.

Fiona Heiford
Manager, Taxpayer Rulings

Special Determination S53: Application of the financial arrangements rules to a public-private partnership agreement

This Determination may be cited as Special Determination S53: Application of the financial arrangements rules to a public-private partnership agreement.

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

1.1 This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of operational services in respect of the Facilities by a limited partnership (Contractor LP) under a public-private partnership agreement (the Project Agreement) with the Crown. The sole limited partner in Contractor LP will be Hold LP, holding 100% of Contractor LP.

1.2 The limited partners in Hold LP are:

- a limited partnership (Investment LP) with two limited partners, one of which (Limited Partner A) is a limited liability company and the other of which (Limited Partner B) is itself a limited partnership having multiple limited partners, some of whom are exempt from income tax;
- a limited liability company (Limited Partner C).

1.3 Limited Partner A, Limited Partner C and each limited partner of Limited Partner B that is not exempt from income tax are together referred to as the Taxable Limited Partners. This determination only applies to the Taxable Limited Partners and does not apply to those limited partners that are exempt from income tax.

1.4 The Project Agreement comprises three basic components for each Facility:

- A design and construction phase (the D&C Phase) under which Contractor LP agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;
- A Facility Lease entered into by Contractor LP and the Crown, under which Contractor LP pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and
- An Operating Term (the O&M Phase) under which, in consideration for quarterly payments (the Unitary Charge), Contractor LP will provide operational services to the Crown over a term beginning once the Facility is ready for operation and ending on the Expiry Date (9 December 2043).

1.5 The Partnership will enter into:

- A Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct each Facility in consideration for monthly and milestone payments; and
- An Operational Services Sub-Contract (the Operational Services Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operational (and other) services in consideration for quarterly payments.

1.6 The Partnership will raise external debt from a range of third party financiers (the Senior Debt).

1.7 Investment LP and Limited Partner C will each provide investment support (Sponsor Support) during the D&C Phase in the form of a letter of credit (Letter of Credit) or cash collateral. In addition, regardless of the form of the Sponsor Support, sponsor support fees will be payable by both Contractor LP and Hold LP (the Sponsor Support Fees). Investment LP may procure that its Sponsor Support is provided by its limited partners (Limited Partner A and Limited Partner B), in which case a Sponsor Support Fee will also be payable by Investment LP to Limited Partner A and Limited Partner B.

1.8 The Partnership will enter into Interest Rate Swaps in respect of the Senior Debt.

1.9 The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and Operational Services Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Senior Debt, Letters of Credit, agreements to pay the Sponsor Support Fees and Interest Rate Swaps are financial arrangements to which Contractor LP is a party. The Project, including all of these agreements, is a wider financial arrangement.

1.10 This determination prescribes:

- the amount of consideration that is solely attributable to each Facility Lease;
- how the financial arrangements rules apply to the O&M Phase of the Project Agreement, the Construction Agreement and the Operational Services Contract for each Facility; and

- the method for spreading the payments made under the Senior Debt, Interest Rate Swaps, Letters of Credit and Sponsor Support Fees.

2. Reference

This determination is made under ss 90AC(1)(bb), 90AC(1)(d) and 91AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

3.1 This determination applies to Contractor LP in respect of the Project (which is set out in detail in Private Ruling BR Prv 17/19, issued on 5 April 2017), including the following arrangements:

- The D&C Phase of the Project Agreement, under which Contractor LP agrees to design and construct each Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) for each Facility once the Facility is ready for operation.
- The O&M Phase of the Project Agreement, under which Contractor LP will provide on-going operational services to the Crown in consideration for quarterly payments for the period following completion of each Facility until 9 December 2043.
- The Facility Lease for each Facility, under which Contractor LP will lease the Facility from the Crown for a period following completion of the relevant Facility until 9 December 2043 and will make the Rental Prepayment to the Crown. The Rental Prepayment will be equal to and will offset the D&C Payment.
- A Construction Agreement with the Contractor, under which the Contractor will design and construct each Facility in consideration for payments under the Construction Agreement.
- An Operational Services Contract with the Service Provider following completion of each Facility, under which the Service Provider will provide the on-going operational (and other) services in consideration for payments under the Operational Services Contract.
- Senior Debt, under which Contractor LP will borrow an agreed sum from external lenders for a term of 5 years from financial close of the Project (Financial Close). The Senior Debt will include a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date. It is expected that the Senior Debt will be refinanced within 5 years of Financial Close and every 5 years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this Determination), the Senior Debt (and any subsequent re-financings) will initially be recognised at fair value plus integral fees, and subsequently measured using the amortised cost using the effective interest method (regardless of whether hedge accounting is applied). The amount of the Senior Debt may be increased by way of an Accordion Facility in order to fund any Additional Schools. The Senior Debt (including the Accordion Facility and any subsequent re-financings) will not be treated as a hedge of another financial arrangement.
- Interest Rate Swaps, under which Contractor LP will pay a fixed rate of interest to the swap counterparties, and receive a floating rate in return.
- If Investment LP (or its limited partners) or Limited Partner C provide their sponsor support by way of a Letter of Credit a fee (the LC Fee) will be payable by Investment LP (or its limited partners) or Limited Partner C (respectively) to the provider of the Letter of Credit in consideration for the provider issuing the Letter of Credit in favour of the Hold LP and the Senior Lenders.
- Regardless of the form of the Sponsor Support, Sponsor Support Fees will be payable by Hold LP to each of Investment LP and Limited Partner C in consideration for the provision of such Sponsor Support (Hold LP Sponsor Support Fees). Contractor LP will in turn be required to pay an amount equal to any Hold LP Sponsor Support Fees to Hold LP (Contractor LP Sponsor Support Fees). If Investment LP procures that Limited Partner A and Limited Partner B provide its Sponsor Support, Investment LP will pay an amount equal to the Hold LP Sponsor Support Fee received by it to each of Limited Partner A and Limited Partner B on a pro rata basis (Investment LP Sponsor Support Fees). (Together, the Hold LP Sponsor Support Fees, Contractor LP Sponsor Support Fees and Investment LP Sponsor Support Fees are the Sponsor Support Fees.)

3.2 This determination is made subject to the following conditions:

- Limited Partner A, Limited Partner B and Limited Partner C use IFRSs to prepare financial statements and to report for financial arrangements. Any Taxable Limited Partner that does not use IFRSs to prepare financial statements and to report for financial arrangements will use the same spreading method as Limited Partner B.

- The Taxable Limited Partners will recognise income derived from the Crown and will deduct expenditure incurred, under the relevant provisions of the Act to the extent that the financial arrangement rules do not apply to these amounts.
- The continued application of Private Ruling BR Prv 17/19 issued on 5 April 2017 (including any Ruling issued to replace that Ruling, provided that the change to the Ruling does not affect the application of this determination).

4. Principle

4.1 Each Facility Lease is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(2) to (16) is not an amount that is taken into account under the financial arrangements rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to a Facility Lease that are not taken into account under the financial arrangements rules.

4.2 For each Facility, the O&M Phase, Construction Agreements and Operational Service Contracts are "short-term agreements for sale and purchase" as defined in s YA 1, and are excepted financial arrangements under s EW 5(22), provided that payment under the Construction Agreements and Operational Services Contracts is required within 93 days of an invoice being rendered. Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by Contractor LP in respect of the O&M Phase, Construction Agreements and Operational Services Contracts are required to be spread under the financial arrangements rules.

4.3 The D&C Phase for each Facility, Senior Debt, Interest Rate Swaps, Letters of Credit, and agreements by Contractor LP, Hold LP and (if applicable) Investment LP to pay Sponsor Support Fees in consideration for sponsor support are "financial arrangements" under s EW 3. This determination specifies that the payments made to or by the Taxable Limited Partners, in proportion to their share in Hold LP, under the Senior Debt, Letters of Credit, agreement to pay Sponsor Support Fees, and Interest Rate Swaps must be spread under the financial arrangements rules in accordance with this determination.

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.
- Capitalised terms have the same meaning as set out in the Project Agreement.
- **IFRS** means International Financial Reporting Standards as defined in s YA 1.

6. Method

6.1 The Rental Prepayment paid in respect of a Facility Lease, and the property interest granted to Contractor LP under a Facility Lease, are solely attributable to the Facility Lease and are not taken into account under the financial arrangements rules.

6.2 For each Facility, the Taxable Limited Partners are not required to spread any amounts under the financial arrangements rules in respect of the:

- O&M Phase of the Project Agreement;
- Construction Agreement;
- Operational Services Contract.

6.3 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Senior Debt and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.

6.4 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of any subsequent refinancing of the Senior Debt over the term of the relevant refinancing, provided that the terms of any such refinancing are materially similar to the terms of the Senior Debt. This determination paragraph does not affect each Taxable Limited Partner's obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.

6.5 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) in respect of additional Senior Debt provided by way of an Accordion Facility over the term of the relevant Accordion Facility, provided that the Accordion Facility is entered into on terms materially similar to the terms of the existing Senior Debt.

6.6 None of the mandatory spreading methods in ss EW 15H or EW 15I apply to the Interest Rate Swaps. Over the term of the Interest Rate Swaps, income or expenditure may be allocated using either:

- the expected value method in s EW 15F (other than for "non-contingent fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which the "fair value method" is used; or
- the IFRS financial reporting method in s EW 15D (other than for "non-integral fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which a method other than the IFRS financial reporting method is used;

provided that each Taxable Limited Partner uses the same method for the entire term of the Interest Rate Swaps.

6.7 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Letters of Credit and the agreements by Contractor LP, Hold LP and (if applicable) Investment LP to pay Sponsor Support Fees in consideration for sponsor support, provided that they are not treated as a hedge of another financial arrangement. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.

6.8 This determination does not affect each Taxable Limited Partner's obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps.

7. Example

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

This example is based on the following parameters:

Commencement of D&C Phase	7 April 2017
Completion of D&C Phase	1 February 2019
Completion of O&M Phase	9 December 2043
D&C Payment from the Crown	$1,000
Aggregate payments to the Contractor	($850)
Facility Lease prepayment	($1,000)
Quarterly payments from the Crown during the O&M Phase	$30
Quarterly payments to the Service Provider	($15)
Annual interest on the Senior Debt	($85)
Annual Hold LP Sponsor Support Fee	($15)
Annual Contractor LP Sponsor Support Fee	($15)
Annual LC Fee	($15)
Annual net payments in respect of the Interest Rate Swaps	($7)

The Taxable Limited Partners are not required to spread any amounts under the financial arrangements rules in respect of the Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract.

The amounts that must be spread under the financial arrangement rules are:

- Interest on the Senior Debt (including the Accordion Facility and any subsequent re-financings) calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F or the IFRS financial reporting method in s EW 15D; and
- Payments made and amounts received in respect of the Letters of Credit and Sponsor Support Fees calculated in accordance with the IFRS financial reporting method in s EW 15D.

This Determination is signed by me on the 5th day of April 2017.

Howard Davis
Director, Taxpayer Rulings

Foreign currency amounts – conversion to New Zealand dollars (for the 12 months ending 31 March 2017)

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company ("CFC") and foreign investment fund ("FIF") rules for the 12 months ending 31 March 2017.

The Income Tax Act 2007 ("2007 Act") requires foreign currency amounts to be converted into New Zealand dollars applying one of the following methods:

- actual rate for the day for each transaction (including close of trading spot exchange rate on the day), or
- rolling 12-month average rate for a 12-month accounting period or income year (see the table **Currency rates 12 months ending 31 March 2017 – rolling 12-month average**), or
- mid-month actual rate as the basis of the rolling average for accounting periods or income years greater or lesser than 12 months (see the table **Currency rates 12 months ending 31 March 2017 – mid-month actual**).

Legislation enacted in September 2010 with effect from 1 April 2008 permits the Commissioner to set currency rates and approve methods of calculating exchange rates. The Commissioner can set rates for general use by taxpayers or for specific taxpayers. The Commissioner's ability to set rates and approve methods applies in circumstances where the 2007 Act does not contain a specific currency conversion rule (sections YF 1(5) and (6)), or in circumstances where the 2007 Act provides a rate or method for currency conversion (section YF 2).

Inland Revenue uses wholesale rates from Bloomberg for rolling 12-month average, mid-month actual and end of month. These rates are provided in three tables.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note: All section references relate to the 2007 Act.

Actual rate for the day for each transaction

The actual rate for the day for a transaction can be used in the following circumstances:

- where the 2007 Act does not provide a specific currency conversion rule, then foreign currency amounts can be converted by applying the close of trading spot exchange rate on the date the transaction is required to be measured or calculated (section YF 1(2))
- where a person chooses to use the actual rate for the day of the transaction when calculating their FIF income or loss by applying the comparative value method, fair dividend rate method, deemed rate of return method or the cost method (section EX 57(2)(a))
- where a person chooses to use the close of trading spot exchange rate to convert foreign income tax paid by a CFC (section LK 3(a)) or by a FIF where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(a)).

Unless the actual rate is the rate for the 15th or the last day of the month, these rates are not supplied by Inland Revenue.

The table **Currency rates 12 months ending 31 March 2017 – month end** provides exchange rates for the last day of the month. These are provided for convenience to assist taxpayers who may need exchange rates on those days.

Currency rates 12 months ending 31 March 2017 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average. This table should be used where the accounting period or income year encompasses 12 complete months.

This table can be used to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods of 12 months
- FIF income or loss calculated under the attributable FIF income method (section EX 50(3)(a)) for accounting periods of 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of 12 months
- calculating the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of 12 months.

Currency rates 12 months ending 31 March 2017 – mid-month actual table

This table sets out the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted. This table can be used as the basis of the rolling average where the accounting period or income year is less than or greater than 12 months (see Example 4). You can also use the rates from this table as the actual rate for any transactions arising on the 15th of the month.

This table can be used as the basis of the rolling average for calculating:

- FIF income or loss under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods or income years of less than or greater than 12 months
- FIF income or loss calculated under the attributable FIF income method (section EX 50(3)(a)) for accounting periods of less than or greater than 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of less than or greater than 12 months
- the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippine company (which is a FIF but does produce a guaranteed yield) on 6 September 2015. Its opening market value on 1 October 2016 or its closing market value on 30 September 2016 is PHP 350,000. Using the comparative value method and applying the actual rate for the day (section EX 57(2)(a)), the opening market value is converted as follows:

PHP 350,000 ÷ 35.184 = $9,947.70

(In this example, the rate selected is the month-end rate for September 2016 for PHP. Refer to the table "Currency rates 12 months ending 31 March 2017 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 31 December 2016. Attributed CFC income for the period 1 January 2016 to 31 December 2016 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 5.3892 = $37,111.26

(In this example, the rate selected is the rolling 12-month average rate for December 2016 for HKD. Refer to the table "Currency rates 12 months ending 31 March 2017 – rolling 12-month average".)

Example 3

A resident individual with a 31 October 2016 accounting period acquired a FIF interest in a Japanese company on 1 November 2015 for 10,500,000 yen. The interest is sold in October 2016 for 10,000,000 yen. Using the comparative value method and applying section EX 57(2)(b), these amounts are converted as:

JPY 10,500,000 ÷ 75.6837 = $138,735.29

JPY 10,000,000 ÷ 75.6837 = $132,128.85

(In this example, the rolling 12-month rate for October 2016 for JPY has been applied to both calculations. Refer to the table "Currency rates 12 months ending 31 March 2017 – rolling 12-month average".)

Example 4

A CFC resident in Singapore was formed on 19 April 2016 and has a balance date of 30 September 2016. During the period 1 May 2016 to 30 September 2016, attributed CFC income of 500,000 Singaporean dollars was derived. For the conversion to New Zealand dollars the taxpayer chooses the method set out in section EX 21(4)(b).

1. Calculating the average monthly exchange rate for the complete months May–September 2016:

   0.9288 + 0.9513 + 0.9594 + 0.9683 + 0.9976 = 4.8054

   4.8054 ÷ 5 = 0.96108

2. Round exchange rate to four decimal places: 0.9611

3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 0.9611 = $520,237.23

(In this example, the rates are from the table "Currency rates 12 months ending 31 March 2017 – mid-month actual", from May to September 2016 inclusive for SGD.)

Currency rates 12 months ending 31 March 2017 – rolling 12-month average

Currency	Code	15/04/16	15/05/16	15/06/16	15/07/16	15/08/16	15/09/16	15/10/16	15/11/16	15/12/16	15/01/17	15/02/17	15/03/17
Australia Dollar	AUD	0.9122	0.9123	0.9163	0.9202	0.9248	0.9317	0.9316	0.9335	0.9347	0.9354	0.9358	0.9383
Bahrain Dinar	BHD	0.2538	0.2515	0.2517	0.2533	0.2554	0.2584	0.2591	0.2609	0.2617	0.2638	0.2656	0.2670
Britain Pound	GBP	0.4473	0.4469	0.4508	0.4607	0.4725	0.4840	0.4956	0.5073	0.5170	0.5280	0.5379	0.5468
Canada Dollar	CAD	0.8850	0.8832	0.8870	0.8930	0.8993	0.9093	0.9135	0.9205	0.9213	0.9209	0.9230	0.9276
China Yuan	CNY	4.2961	4.2781	4.3016	4.3578	4.4084	4.4778	4.5131	4.5714	4.6133	4.6683	4.7208	4.7655
Denmark Kroner	DKK	4.5083	4.4732	4.4747	4.5004	4.5335	4.5866	4.6130	4.6463	4.6800	4.7269	4.7783	4.8156
Euporean Community Euro	EUR	0.6043	0.5998	0.6002	0.6037	0.6084	0.6156	0.6193	0.6239	0.6286	0.6351	0.6422	0.6474
Fiji Dollar	FJD	1.4202	1.4134	1.4147	1.4197	1.4259	1.4363	1.4366	1.4411	1.4438	1.4532	1.4588	1.4655
French Polynesia Franc	XPF	72.1305	71.5893	71.6359	72.0440	72.5960	73.4557	73.8889	74.4212	74.9810	75.7596	76.6071	77.2330
Hong Kong Dollar	HKD	5.2205	5.1756	5.1782	5.2122	5.2559	5.3184	5.3344	5.3711	5.3892	5.4303	5.4660	5.4950
India Rupee	INR	44.3204	44.1683	44.3769	44.8480	45.3091	45.8685	46.1070	46.5211	46.7208	47.1643	47.3840	47.4506
Indonesia Rupiah	IDR	9,122.5842	9,065.7333	9,073.6283	9,114.2200	9,148.9992	9,185.7617	9,190.8083	9,241.1392	9,234.0967	9,279.6392	9,333.6225	9,376.4758
Japan Yen	JPY	80.0425	78.7361	77.7509	77.1724	76.4778	76.3236	75.6837	75.4674	75.5369	76.0467	76.5680	76.9983
Korea Won	KOR	781.0371	779.8667	783.2625	787.8284	789.5543	795.6670	798.6646	803.9476	807.1164	811.5332	812.5789	813.0815
Kuwait Dinar	KWD	0.2032	0.2015	0.2015	0.2028	0.2045	0.2069	0.2075	0.2090	0.2098	0.2116	0.2134	0.2148
Malaysia Ringit	MYR	2.7369	2.7442	2.7658	2.7902	2.8086	2.8326	2.8454	2.8647	2.8846	2.9145	2.9513	2.9793
Norway Krone	NOK	5.5647	5.5725	5.6072	5.6624	5.7057	5.7735	5.7964	5.8224	5.8408	5.8701	5.8942	5.9229
Pakistan Rupee	PKR	69.8334	69.3822	69.5573	70.1834	70.9409	71.7835	72.0040	72.5151	72.7778	73.3277	73.8134	74.1937
Phillipines Peso	PHP	31.1839	31.0644	31.1535	31.4326	31.7094	32.1366	32.3856	32.7408	33.0044	33.4012	33.7531	34.0712
PNG Kina	PGK	1.9540	1.9649	1.9913	2.0272	2.0665	2.1098	2.1318	2.1589	2.1768	2.2029	2.2257	2.2432
Singapore Dollar	SGD	0.9317	0.9269	0.9276	0.9326	0.9365	0.9454	0.9488	0.9549	0.9602	0.9675	0.9754	0.9816
Solomon Islands Dollar*	SBD	0.0860	0.0852	0.0851	0.0855	0.0861	0.0871	0.0872	0.0879	0.0882	0.0891	0.0899	0.0905
South Africa Rand	ZAR	9.4129	9.5473	9.7177	9.8999	10.0003	10.1548	10.2556	10.3101	10.2873	10.1862	10.0925	9.9674
Sri Lanka Rupee	LKR	94.2145	94.1320	94.7738	96.0797	97.5417	98.9665	99.6342	100.6901	101.3714	102.6159	103.6611	104.6088
Sweden Krona	SEK	5.6371	5.5924	5.6034	5.6455	5.6915	5.7686	5.8205	5.8914	5.9634	6.0304	6.0973	6.1603
Swiss Franc	CHF	0.6524	0.6504	0.6526	0.6586	0.6637	0.6714	0.6756	0.6801	0.6846	0.6902	0.6961	0.7005
Taiwan Dollar	TAI	21.6519	21.6009	21.6939	21.8822	22.0102	22.2178	22.2669	22.3630	22.3899	22.4624	22.4764	22.4624
Thailand Baht	THB	23.6280	23.5406	23.6431	23.8400	23.9984	24.2220	24.3001	24.4410	24.5118	24.6587	24.7922	24.9191
Tonga Pa'anga*	TOP	1.4363	1.4389	1.4496	1.4655	1.4837	1.5029	1.5060	1.5174	1.5212	1.5349	1.5420	1.5500
United States Dollar	USD	0.6730	0.6671	0.6674	0.6718	0.6773	0.6854	0.6873	0.6920	0.6942	0.6998	0.7046	0.7083
Vanuatu Vatu	VUV	73.1571	72.8196	73.0109	73.5937	74.0515	74.8661	74.9617	75.3334	75.6205	76.0922	76.4752	76.8468
West Samoan Tala*	WST	1.7263	1.7226	1.7295	1.7416	1.7546	1.7678	1.7647	1.7690	1.7664	1.7734	1.7786	1.7851

Notes to table:

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The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2017 – mid-month actual

Currency	Code	15/04/16	15/05/16	15/06/16	15/07/16	15/08/16	15/09/16	15/10/16	15/11/16	15/12/16	15/01/17	15/02/17	15/03/17
Australia Dollar	AUD	0.8960	0.9311	0.9495	0.9397	0.9394	0.9735	0.9329	0.9395	0.9565	0.9502	0.9368	0.9139
Bahrain Dinar	BHD	0.2608	0.2553	0.2653	0.2684	0.2718	0.2757	0.2672	0.2677	0.2654	0.2687	0.2723	0.2656
Britain Pound	GBP	0.4872	0.4714	0.4952	0.5396	0.5596	0.5526	0.5815	0.5702	0.5667	0.5852	0.5797	0.5732
Canada Dollar	CAD	0.8874	0.8764	0.9082	0.9228	0.9317	0.9626	0.9317	0.9549	0.9386	0.9347	0.9449	0.9373
China Yuan	CNY	4.4818	4.4221	4.6279	4.7649	4.7864	4.8813	4.7711	4.8707	4.8803	4.9147	4.9504	4.8342
Denmark Kroner	DKK	4.5632	4.4524	4.6450	4.7986	4.7957	4.8454	4.8066	4.9297	5.0240	4.9820	5.0658	4.8785
Euporean Community Euro	EUR	0.6133	0.5985	0.6247	0.6449	0.6446	0.6507	0.6459	0.6623	0.6759	0.6700	0.6814	0.6564
Fiji Dollar	FJD	1.4265	1.4186	1.4631	1.4603	1.4749	1.5006	1.4484	1.4686	1.4758	1.4986	1.4830	1.4674
French Polynesia Franc	XPF	73.1802	71.4155	74.5843	76.6980	76.8850	77.6171	77.0707	78.9873	80.6425	79.9864	81.2998	78.4289
Hong Kong Dollar	HKD	5.3652	5.2539	5.4587	5.5159	5.5912	5.6764	5.5019	5.5096	5.4619	5.5299	5.6043	5.4712
India Rupee	INR	46.0296	45.4202	47.2691	48.0811	48.1961	48.7689	47.3783	48.1904	47.8933	48.5749	48.0134	45.5924
Indonesia Rupiah	IDR	9103.0500	9065.2600	9384.2600	9414.6200	9435.5700	9554.3000	9259.6100	9516.2600	9471.8800	9475.3600	9563.2700	9274.2700
Japan Yen	JPY	75.1980	73.4500	74.5600	74.6150	73.0020	74.6810	73.7840	77.5480	83.1720	81.6500	82.4530	79.8670
Korea Won	KOR	793.4684	796.4237	822.4295	811.0064	791.5002	822.7427	805.4500	828.8583	832.7209	837.3749	820.0207	794.9819
Kuwait Dinar	KWD	0.2087	0.2041	0.2120	0.2149	0.2175	0.2205	0.2146	0.2161	0.2155	0.2178	0.2207	0.2150
Malaysia Ringit	MYR	2.6969	2.7426	2.8796	2.8369	2.8904	3.0121	2.9828	3.0864	3.1670	3.1746	3.1949	3.0871
Norway Krone	NOK	5.7082	5.5556	5.8438	6.0363	5.9209	6.0218	5.8264	5.9880	6.1019	6.0632	6.0217	5.9871
Pakistan Rupee	PKR	72.4638	70.9220	73.5294	74.6269	75.7576	76.3359	74.0741	74.6269	74.0741	74.6269	75.7576	73.5294
Phillipines Peso	PHP	31.8681	31.6990	32.5618	33.6046	33.5267	34.6788	34.3891	34.9560	35.4069	35.3779	35.8535	34.9320
PNG Kina	PGK	2.1656	2.1430	2.2266	2.2537	2.2857	2.3189	2.2469	2.2520	2.2350	2.2638	2.2949	2.2325
Singapore Dollar	SGD	0.9394	0.9288	0.9513	0.9594	0.9683	0.9976	0.9853	1.0038	1.0152	1.0184	1.0248	0.9872
Solomon Islands Dollar*	SBD	0.0874	0.0869	0.0894	0.0913	0.0922	0.0936	0.0909	0.0908	0.0900	0.0909	0.0924	0.0901
South Africa Rand	ZAR	10.0693	10.4269	10.7250	10.3684	9.5890	10.4137	10.1488	10.0672	9.8291	9.6322	9.3283	9.0105
Sri Lanka Rupee	LKR	100.0000	99.0099	102.0408	104.1667	105.2632	106.3830	104.1667	105.2632	105.2632	107.5269	108.6957	107.5269
Sweden Krona	SEK	5.6270	5.5851	5.8457	6.1111	6.0965	6.2047	6.2663	6.5244	6.6217	6.3533	6.4426	6.2452
Swiss Franc	CHF	0.6698	0.6601	0.6762	0.6993	0.7014	0.7109	0.7017	0.7113	0.7250	0.7194	0.7262	0.7046
Taiwan Dollar	TAI	22.3731	22.1320	22.7510	22.7538	22.5820	23.1441	22.4950	22.6192	22.4731	22.5187	22.2183	21.4886
Thailand Baht	THB	24.2346	23.9751	24.7964	24.8934	24.9486	25.5204	25.0415	25.1737	25.1820	25.2536	25.3000	24.7098
Tonga Pa'anga*	TOP	1.5180	1.5010	1.5233	1.5440	1.5680	1.5860	1.5411	1.5572	1.5384	1.5866	1.5754	1.5615
United States Dollar	USD	0.6919	0.6775	0.7034	0.7116	0.7211	0.7316	0.7087	0.7101	0.7038	0.7131	0.7223	0.7045
Vanuatu Vatu	VUV	74.6269	74.0741	76.9231	76.9231	76.9231	78.7402	76.3359	76.9231	77.5194	78.1250	78.1250	76.9231
West Samoan Tala*	WST	1.7614	1.7439	1.8027	1.7839	1.8258	1.8524	1.7897	1.7645	1.7488	1.7525	1.8110	1.7851

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Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2017 – month end

Currency	Code	30/04/16	31/05/16	30/06/16	31/07/16	31/08/16	30/09/16	31/10/16	30/11/16	31/12/16	31/01/17	28/02/17	31/03/17
Australia Dollar	AUD	0.9174	0.9348	0.9576	0.9486	0.9643	0.9504	0.9397	0.9591	0.9620	0.9639	0.9393	0.9185
Bahrain Dinar	BHD	0.2630	0.2550	0.2692	0.2718	0.2733	0.2746	0.2696	0.2670	0.2610	0.2756	0.2711	0.2642
Britain Pound	GBP	0.4776	0.4670	0.5360	0.5448	0.5518	0.5615	0.5840	0.5663	0.5611	0.5812	0.5809	0.5585
Canada Dollar	CAD	0.8760	0.8855	0.9221	0.9392	0.9501	0.9562	0.9588	0.9517	0.9308	0.9527	0.9566	0.9328
China Yuan	CNY	4.5193	4.4517	4.7395	4.7856	4.8410	4.8541	4.8375	4.8852	4.8144	5.0196	4.9386	4.8189
Denmark Kroner	DKK	4.5358	4.5192	4.7777	4.7985	4.8362	4.8274	4.8430	4.9753	4.8943	5.0350	5.0549	4.8919
Euporean Community Euro	EUR	0.6092	0.6076	0.6424	0.6449	0.6497	0.6480	0.6510	0.6689	0.6578	0.6770	0.6801	0.6577
Fiji Dollar	FJD	1.4368	1.4327	1.4778	1.4925	1.4912	1.4821	1.4622	1.4784	1.4658	1.5108	1.4799	1.4455
French Polynesia Franc	XPF	72.6964	72.5476	76.7234	76.9519	77.5531	77.3980	77.7170	79.7558	78.5380	80.8162	81.0130	78.3671
Hong Kong Dollar	HKD	5.4127	5.2564	5.5354	5.5921	5.6236	5.6519	5.5443	5.4934	5.3770	5.6724	5.5827	5.4445
India Rupee	INR	46.3169	45.4118	48.1223	47.6976	48.5459	48.4502	47.7311	48.8727	47.2926	49.3832	48.0192	45.3103
Indonesia Rupiah	IDR	9182.38	9171.76	9389.33	9307.75	9626.98	9466.34	9329.97	9704.63	9363.53	9721.18	9586.12	9307.20
Japan Yen	JPY	74.1930	74.8850	73.6280	73.5150	74.9760	73.8370	74.9430	81.0580	80.9800	82.4700	81.1010	78.0580
Korea Won	KOR	798.8798	805.3391	822.5842	801.3558	809.2674	802.7345	817.6640	834.2442	836.7783	841.7611	817.4239	783.0537
Kuwait Dinar	KWD	0.2104	0.2046	0.2155	0.2180	0.2189	0.2195	0.2167	0.2162	0.2117	0.2228	0.2197	0.2137
Malaysia Ringit	MYR	2.7200	2.7748	2.8639	2.8927	2.9488	3.0032	3.0007	3.1972	3.1176	3.2197	3.1917	3.0914
Norway Krone	NOK	5.6244	5.6643	5.9662	6.0867	6.0401	5.8139	5.9065	6.0374	5.9862	6.0294	6.0370	6.0191
Pakistan Rupee	PKR	72.9927	70.9220	74.6269	75.7576	75.7576	76.3359	75.1880	74.6269	72.4638	76.3359	75.1880	73.5294
Phillipines Peso	PHP	32.6835	31.4364	33.5377	33.4720	33.7794	35.1840	34.6439	35.5680	34.4745	36.2314	36.1355	35.0758
PNG Kina	PGK	2.1984	2.1410	2.2588	2.2855	2.2983	2.3094	2.2666	2.2491	2.2040	2.3240	2.2849	2.2293
Singapore Dollar	SGD	0.9379	0.9318	0.9610	0.9658	0.9878	0.9933	0.9948	1.0151	1.0022	1.0308	1.0091	0.9792
Solomon Islands Dollar*	SBD	5.4821	5.2747	5.5641	5.6148	5.6546	5.6826	5.5774	5.5243	5.4081	5.7208	5.6139	5.4727
South Africa Rand	ZAR	9.9276	10.6254	10.5093	10.0025	10.6797	10.0039	9.6312	9.9853	9.5146	9.8524	9.4425	9.4115
Sri Lanka Rupee	LKR	102.0408	100.0000	104.1667	105.2632	105.2632	106.3830	105.2632	105.2632	104.1667	109.8901	109.8901	106.3830
Sweden Krona	SEK	5.6044	5.6365	6.0338	6.1698	6.2051	6.2418	6.4587	6.5384	6.3052	6.3918	6.5000	6.2850
Swiss Franc	CHF	0.6695	0.6722	0.6964	0.6987	0.7132	0.7078	0.7072	0.7205	0.7060	0.7232	0.7234	0.7027
Taiwan Dollar	TAI	22.5227	22.0425	22.9809	22.9327	23.0181	22.7913	22.5324	22.6148	22.4297	22.7767	22.0490	21.2499
Thailand Baht	THB	24.3593	24.1912	25.0534	25.0501	25.0994	25.2006	25.0371	25.2889	24.8300	25.6640	25.1360	24.0810
Tonga Pa'anga*	TOP	1.5274	1.5226	1.5865	1.5868	1.5762	1.5787	1.5539	1.5544	1.5458	1.6103	1.5629	1.5555
United States Dollar	USD	0.6977	0.6763	0.7134	0.7199	0.7250	0.7286	0.7151	0.7083	0.6934	0.7312	0.7192	0.7006
Vanuatu Vatu	VUV	75.7576	74.6269	78.1250	78.7402	78.7402	78.1250	76.3359	77.5194	78.1250	79.3651	77.5194	76.3359
West Samoan Tala*	WST	1.7655	1.7603	1.8052	1.8323	1.8357	1.8219	1.8031	1.7600	1.7707	1.8382	1.7966	1.7726

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Source: Bloomberg CMPN BGN

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.

Are Embankments and Runway End Safety Areas Depreciable Property? No says the Court of Appeal.

Case	Queenstown Airport Corporation Limited v Commissioner of Inland Revenue [2017] NZCA 20
Decision date	22 February 2017
Act(s)	Income Tax Act 2007 ss DA 1, EE 1, EE 6, EE 7, EE 37, EE 67 and Schedule 13
Keywords	RESA, runway end safety area, depreciable land improvement, embankment, airport, hardstanding, decline in value, schedule 13, geogrid

Summary

Due to updated Civil Aviation Rules, Queenstown Airport Corporation Limited ("QA") was required to provide a minimum 90-metre Runway End Safety Area ("RESA") at each end of its runway. Due to the steep drop-off into the Shotover River on the east end of the runway, QA constructed a 45-metre high embankment upon which to place the RESA and sought to deduct the construction costs on the basis the RESA was a depreciable land improvement.

The High Court rejected this argument and QA appealed. The Court of Appeal agreed with the High Court, and found that the allowed depreciable land improvements contained within Schedule 13 was an exhaustive list. There was no indication that a generous interpretation could be taken to allow items such as RESAs to be included. The Court also agreed that the RESA was not the same as an airport runway, was not an improvement to a runway, and was not hardstanding so could not fall within those categories of depreciable land improvement. Nor was the RESA expected to decline in value. For these reasons the Court dismissed the appeal.

Impact

In general, the judgment provides a useful guidance as to how Courts will interpret ss EE 1, EE 6, EE 7 and Schedule 13 of the Income Tax Act 2007 ("ITA"). It also supports the approach to statutory interpretation adopted in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 ("*Fonterra*").

More specifically, the judgment illustrates the factors that will be taken into account when determining whether or not a RESA will come within any of the items of depreciable land improvements contained in Schedule 13 of the ITA.

Facts

QA is the owner and operator of the Queenstown Airport. The dispute concerns depreciation deductions for income tax purposes.

The appellant expended some $8.7 million in constructing QA's eastern RESA which was required under the Civil Aviation Rules. Due to the steep 45-metre drop-off into the Shotover River on the east end of the runway, QA formed a very substantial supporting embankment for the RESA. In the 2012 and 2013 income tax years, the appellant sought to deduct amounts for depreciation on the basis that the east RESA was an "airport runway" under the ITA, or alternatively, that the depreciation deductions were permitted as "hardstanding" or as a "road". The Commissioner of Inland Revenue ("the Commissioner") disallowed the deductions.

LEGAL DECISIONS – CASE NOTES

High Court decision

The dispute was first heard by the High Court, who held that the deductions were not permitted as the east RESA did not fit within any of the descriptions relied upon by the appellant (*Queenstown Airport Corporation Ltd v Commissioner of Inland Revenue* [2016] NZHC 1299, (2016) 27 NZTC 22-054).

The appellant appealed this decision.

The Appellant's arguments

The appellant submitted that the High Court erred in concluding that the east RESA was not an airport runway or hardstanding under ss EE 6, EE 7 and Schedule 13 of the ITA. The appellant did not appeal the High Court finding that the east RESA was a "road" under the ITA.

Decision

The Court of Appeal ("the Court") dismissed the appeal. They did not agree with the appellant's argument that the High Court lost sight of the proper approach to the statutory interpretation question. The Court commented that the High Court followed the approach of *Fonterra* at [22] in considering the meaning of the enactment from the text in light of its purpose, having regard to the immediate and the general legislative context and the social, commercial or other objective of the enactment and crosschecking the meaning against the purpose.

The interpretation issue – Analysis

Depreciation policy

The Court stated that the policy underlying the current depreciation rules in the ITA is to allow the deduction of the cost of depreciation in respect of assets used or available for use in deriving assessable income when the value of those assets is reasonably expected to decline in value over their estimated useful life. The rationale for allowing a deduction for depreciation is that capital assets used in the production of income will eventually wear out and need to be replaced in whole or in part. Land (apart from certain specified land improvements) is not depreciable because it does not have a determinate design life after which replacement in whole or in part is expected to be necessary; nor is it expected to decline in value over time through ordinary wear and tear.

The Court concluded that the text of the ITA makes it clear that the items listed as improvements in schedule 13 are exceptions to the general rule that land is not depreciable. In the Court's view, there is nothing to suggest Parliament intended that the generous approach advocated by the appellant should be adopted in interpreting the specified items. The structure of the relevant provisions does not support this. Rather, Parliament has chosen to specify the items it has concluded are to be treated as exceptions to the general prohibition on the depreciation of land.

"Airport Runway"

The Court stated that the eastern RESA does not form part of the runway either in its natural meaning or as "airport runway" is defined under the Civil Aviation Rules. The eastern RESA was not intended or available for use by aircraft taking off or landing other than for use for safety reasons in an emergency.

Unlike the airport runway, which has a five- to 10-year design life after which its surface will require complete replacement; the eastern RESA's overall design life is at least 120 years, after which only one of its components (the Geogrids) is likely to require major work.

"RESA as an Improvement to the Airport Runway"

The Court noted the appellant's submission, made in his reply that a deduction for depreciation should be allowed, under s EE 37 of the ITA, as the eastern RESA was an improvement to an item of depreciable property. The Court noted that "improvement" is defined in s EE 67 of the ITA as an "alteration, extension or repair of an item of depreciable property that increases its capital value."

The appellant submitted that the eastern RESA was an extension of the airport runway, an acknowledged depreciable asset.

The Court was unable to accept the argument as they did not find the eastern RESA and supporting embankment could be regarded as an extension of the airport runway. As the Court found the eastern RESA was not "airport runway", it also found, for the same reasons, that it cannot be regarded as an extension of the airport runway.

Hardstanding

The Court agreed with the High Court that the eastern RESA is not "hardstanding" for the purposes of the depreciation provisions. The Court noted that the eastern RESA is designed and constructed to allow aircraft to sink into its surface to decelerate the aircraft in an emergency situation and that this is the opposite of an area that is "hard". It also noted that the eastern RESA might be designed to bear the weight of an aircraft for a short period in an emergency, but this does not fall naturally within the meaning of "standing" which refers to an area where a vehicle or aircraft might stand when not in use. There is nothing in the characteristics or purpose of a RESA to suggest otherwise.

Decline in Value

The High Court also found that the eastern RESA was not property that in, normal circumstances might reasonably be expected to decline in value while used or available for use in terms of s EE 6(1) of the ITA. Noting that, given the Court of Appeal's conclusions above, it was not strictly necessary for it to deal with the second element the appellant was required to satisfy before being entitled to deduct depreciation loss, the Court of Appeal gave its view on this issue.

In interpreting s EE 6(1) of the ITA, the Court first stated that "normal circumstances" refers to circumstances that might ordinarily be expected to affect the value of the relevant asset over time (contrasted with "abnormal circumstances" such as an earthquake). Second, the assessment is ordinarily made at the time when the relevant deduction is sought. This necessarily involves a prediction of future events. Third, the test is objective – it would not be sufficient for a taxpayer to believe that the asset might deteriorate in time. There must be a reasonable basis for that expectation. Fourth, the expression "might reasonably be expected to decline in value" sets a relatively low threshold. So long as there is a reasonable prospect that the asset might decline in value in the future, that is sufficient. Fifth, it is not necessary that the asset is actually used, only that it is available for use. Finally, the test does not require that the asset in question would require complete replacement at the end of its useful life (See, by analogy, the discussion of the distinction between repairs or maintenance and improvements of a capital nature in *Poverty Bay Electric Power Board v Commissioner of Inland Revenue* [1999] 2 NZLR 438 (CA) at 445). Nevertheless, the extent, nature and cost of any work required to reinstate the relevant asset may have a material bearing on the assessment of whether a decline in value might reasonably be expected.

The Court of Appeal noted that contrary to the view of the High Court, the expert evidence that Geogrids reached the end of their design life after about 120 years and that major work would then be required must be accepted, although it should be considered in context. The Court noted that the Geogrids, while an important component of the overall eastern RESA, comprised only a minor part of the overall structure, which is massive in scale.

The Court concluded that there was no evidence to suggest that any work would be required to repair or reinstate the great majority of the compacted soils and gravels comprising the eastern RESA (only the Geogrids would require replacement). The Court noted that no evidence was placed before the High Court as to the extent and nature of any work required at the end of the Geogrid design life, the cost of that work or the anticipated effect on the value of the asset overall. The Court of Appeal stated that it was reasonable to infer on the evidence that the cost and any consequent effect on the long term value of the asset would likely amount only to a small fraction of the cost of the structure overall. Any amount properly deductible as depreciation would accordingly be reduced to a very low level.

Dr Emery's brief of evidence

The Court of Appeal noted that the High Court did not make a ruling on the challenged admissibility of Dr Emery's brief, but it made no reference to this evidence in the judgment. Given that the Court of Appeal could not determine what weight, if any, the High Court placed on Dr Emery's evidence, and given that the Commissioner's counsel accepted that the Commissioner was not prejudiced by the High Court's failure to rule on the admissibility (because she was able to put the relevant, but challenged parts of Dr Emery's briefs to the appellant's witnesses), the Court of Appeal did not place any weight on the brief for the purposed of its judgment and no ruling as to the admissibility of that evidence was required.

Court of Appeal dismisses Honk Land Trustee Limited's appeal in relation to a $1.1m management fee tax deduction

Case	Honk Land Trustees Limited v Commissioner of Inland Revenue [2017] NZCA 54
Decision date	10 March 2017
Act(s)	Income Tax Act 1994 ss BD 2, BG 1 and GB 1 Tax Administration Act 1994 ss 141B and 141D
Keywords	"Management fee" "deduction" "avoidance" "related entities"

Summary

The Court of Appeal upheld decisions of the High Court and the Taxation Review Authority ("the TRA") confirming the Commissioner of Inland Revenue's ("the Commissioner") disallowance of a $1,116,000 management fee for income tax purposes. The Court of Appeal dismissed Honk Land Trustees Limited's ("HLT") appeal on the following alternative grounds: (1) there was no satisfactory evidence to show that management services were in fact provided; (2) there was no sufficient nexus shown; and (3) in the event the management fees were deductible, they were nevertheless part of a void tax avoidance arrangement. Additionally, the Court of Appeal agreed that the Commissioner was entitled to impose abusive tax position shortfall penalties.

Impact

The Court of Appeal provided statements on the deductibility of management fees between related entities, including useful guidance as to what it would expect to see in order to show that management fees were in fact provided.

Introduction

This case is a further appeal by HLT of the TRA's decision confirming an assessment made by the Commissioner disallowing a $1,116,000 income tax deduction HLT claimed in the 2005 income year. The deduction related to a management fee that, in its capacity as the corporate trustee of Honk Land Trust ("the Trust"), HLT had paid to a related entity, Honk Land Limited ("HLL").

The High Court (per Ellis J) found that the TRA was correct to find that no management services were provided by HLL to the Trust. HLT appealed Ellis J's decision to the Court of Appeal.

The essence of the decision of the TRA, endorsed by the High Court, was:

1. The management fees were not deductible because there was insufficient proof they related to any relevant services actually provided by HLL.
2. Alternatively, the charging of the fees was a contrivance designed to enable the Trust to avoid paying tax.
3. The imposition by the Commissioner of a 50 per cent shortfall penalty was appropriate on the ground that HLT had taken an abusive tax position.

Facts

Mr David Andrew Tauber ("Mr Tauber") is the settlor and a discretionary beneficiary of the Trust, which was created in 2002. Initially, HLL was the Trust's corporate trustee but was replaced in July 2004 by HLT.

In 2005 Mr Tauber was the controlling mind of a number of companies and other entities beneficially owned by the Trust. HLT directly owned Honk Group Limited which, in turn, directly and indirectly owned various other companies undertaking different business activities. HLL was one of those subsidiary companies.

The Trust's financial statements in the 2005 income year included a management fee expense of $1,116,000 to HLL. The income tax effect of this management fee was that the Trust had no tax to pay. In turn, HLL offset the $1,116,000 payment it received against existing losses with the result that HLL paid no tax on the management fee income.

Decision

Were management services provided by HLL to HLT?

Counsel for HLT submitted that the High Court was wrong to find that HLT had not satisfied the onus of establishing that management services were in fact supplied by HLL to HLT.

Before providing its own analysis, the Court of Appeal set out the reasoning of the High Court and TRA's findings on this point. The Court of Appeal observed that the TRA had noted the absence of any documentary evidence other than the recording

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of the expense in the end-of-year financial statements for both entities, and the absence of any detailed evidence of particular services for which the management fees were charged or for what entity particular work was done. The Court of Appeal also observed that the High Court, having reviewed the transcript of the evidence given before the TRA, had concluded that Mr Tauber's evidence was "implausible, contradictory, vague and equivocal"; that there was a lack of clarity in Mr Tauber's evidence about the extent to which the fee charged included an amount for services allegedly provided in the 2004 year; and that there was a surprising and contradictory shift in Mr Tauber's evidence as to which entity had provided the services to the Trust.

While acknowledging that it was not in dispute that the Trust required some management in respect of its own assets and business, the Court of Appeal held that HLT had simply failed to meet the threshold of identifying what management services were provided to the Trust and did not prove they were performed by HLL.

The Court of Appeal referred to the following key points:

1. in the 2004 income year, HLT paid a total of $378,393 in management fees directly to Basin Ridge Management Limited (Basin Ridge, Mr Tauber's management company) and to another entity associated with Mr Tauber's business associate. HLL did not receive any income from management fees but was charged $424,282 by Basin Ridge;
2. in the 2005 income year (although according to Mr Tauber HLL undertook the management work for all entities in the Honk Group) HLL was charged management fees totalling $497,970 by Basin Ridge and three other providers. That was necessary because HLL had no employees of its own;
3. the 2005 income year was the first and only time HLL charged the Trust management fees, and this expense happened to be claimed in the first year the Trust made a profit;
4. the management fee matched the surplus profit in the Trust and had the effect of eliminating the tax otherwise payable by HLT;
5. the management fee also enabled HLL to offset the amount received against its losses; and
6. without the management fee payment, HLT would have been liable to pay tax of $368,280 and HLL would have had a loss of $966,788 for the year.

The Court of Appeal opined that the lack of documentary evidence and the fact that the management fee amount was decided at or after the end of the financial year (and retrospectively allocated monthly by journal entry) was not necessarily fatal for HLT. The problem for HLT was that Mr Tauber had failed to provide any detailed or convincing explanation as to what management services were provided or how the sum charged was calculated.

The Court of Appeal agreed that the proper inference to draw is that the management fees for 2005 were fixed by reference to HLT's taxable income and for the purpose of eliminating its liability for tax in that year. There was no satisfactory evidence to support the claim that management services were provided by HLL to HLT or in what amount.

Was the High Court correct to find there was no sufficient nexus shown between the management fees and the earning of HLT's assessable income and/or in the course of carrying on its business?

The authorities relating to deductibility of expenses are well known and were not in dispute. HLT submitted that it was difficult to differentiate between management services provided or required for individual entities in the Honk Group. Counsel argued that in such circumstances, with tightly held companies and other entities, it was permissible to take a global approach to the allocation of management fees. This argument was rejected by the Court of Appeal for two main reasons. First, s BD 2 of the Income Tax Act 1994 ("ITA") is focussed on expenditure by the tax-paying entity concerned and which has the required nexus with the derivation of that taxpayer's income. Second, the section permits deductions for expenditure only to the extent that it is incurred for any of the purposes identified in that section. The Court of Appeal noted that "to the extent that" contemplates apportionment between expenditure that is properly attributable to the identified statutory purpose and that which is not.

Although the Court of Appeal acknowledged that complete precision may not always be possible with regard to the division of management services between the members of a group, the Court found that the evidence in this case fell well short of even a modest degree of precision.

Was the High Court correct to hold that if the management fee was deductible, it was part of a tax avoidance arrangement under s BG 1 of the ITA?

The Court of Appeal also considered the Commissioner's alternative submission that if the management fees were deductible under s BD 2 of the ITA, then the transaction was part of a tax avoidance arrangement pursuant to s BG 1. The Court of Appeal said they would have had no difficulty agreeing with the High Court that there was a tax avoidance arrangement. The Court of

Appeal was satisfied that the circumstances in which the management fees were fixed and charged were contrived and artificial and were clearly made for the purpose of eliminating the income tax otherwise payable. The Court of Appeal agreed with the Commissioner that another purpose and effect of the arrangement was not only to eliminate any tax obligation in HLT but was also to transfer taxable profits out of the Trust to HLL which effectively amounted to a loss offset between a company and a trust, which is not permitted.

Additionally the Court of Appeal was satisfied that it would have been unnecessary for the Commissioner to exercise the reconstruction powers available under the ITA. The Court of Appeal agreed with the Commissioner that it was irrelevant that, instead of using the management fee to transfer the Trust profits to HLL, HLT could have distributed the profit to HLL as beneficiary income. Citing the Court's decision in *Alesco New Zealand Ltd v Commissioner of Inland Revenue* [2013] NZCA 40, [2013] 2 NZLR 175 at [39] and [40], the Court of Appeal held that the question was whether the particular arrangement had the effect of avoiding or reducing any liability to income tax; the issue was not whether the taxpayer would have been equally able to avoid or reduce its liability by implementing a different and permissible arrangement.

Was the High Court correct to hold that HLT was liable for an abusive tax position penalty under s 141D of the Tax Administration Act 1994 ("TAA")?

The Court of Appeal agreed that the Commissioner was entitled to impose a shortfall penalty under s 141D of the TAA. The basis for the Court's finding included the following factors: there was clearly a tax shortfall for the 2005 income year, an unacceptable tax position was taken by HLT entering into arrangements with the dominant purpose of reducing or removing its tax liability, and HLT could not have reasonably concluded that it was appropriate to deduct management fees for services not actually provided.

TRA considers residency of individuals

Case	TRA 004/14 [2017] NZTRA 01
Decision date	24 February 2017
Act(s)	Income Tax Act 1994 ss BD1, CG14, CG15, CG 23(9), OE 1, Income Tax Act 2004 ss BD 1, CQ 4, CQ 5, EZ 29, 30, 38, 41, 44, 44B, 44C, 56, 58(4), OB1 (definition: 'foreign superannuation scheme'), OE 1, Income Tax Act 2007 ss BD 1, CQ 5(1), EX 52, 53, 68, 70, YD 1 and Tax Administration Act 1994 s 89 B, 108, 149 A(2)(b) and State Sector Act 1988 s 40
Keywords	Permanent place of abode, residence, foreign investment fund

Summary

This is the first case involving an individual's residence status since the Court of Appeal's decision in *Commissioner of Inland Revenue v Diamond* [2015] NZCA 613 ("*Diamond*"). The Taxation Review Authority ("the Authority"), applying *Diamond*, considered that the disputant, a professional mariner, had a permanent place of abode in New Zealand in the years in dispute.

Facts

The disputant was born in New Zealand. His parents emigrated from Europe and the disputant holds a New Zealand passport as well as one from his parents' homeland.

In the mid-1960s the disputant and his family went back to his parents' homeland where they lived for about 18 months before returning to New Zealand. Upon leaving school, the disputant joined the merchant navy. Since that time he has been employed in various roles by the same shipping company. In 1980 the disputant was married in Asia. He and his wife had a son and the disputant adopted his wife's two daughters from a previous relationship. In late 1987 the family moved to New Zealand.

In 1995, the disputant and his wife separated. The matrimonial home was transferred to his wife and the disputant purchased a unit so that he had somewhere to stay on visits to New Zealand to see his son who was then at secondary school.

In 1998 the disputant met and married his present wife. His wife lived at 27 Brown Road which had previously been transferred to her as a part of a matrimonial property settlement. In 1997 she established a family trust ("Trust") and 27 Brown Road was transferred to her and her solicitor as trustees of that Trust. The disputant became trustee and beneficiary of the Trust in 1999.

In 2000 the disputant's wife began to accompany the disputant on his voyages at sea. Customs records showed that in the 2001 to 2004 tax years, he spent on average 3.5 months in New Zealand during which time he stayed at 27 Brown Road.

The disputant and his wife formed a partnership which eventually owned four rental properties. In February 2004 these properties were sold to the Trust together with furniture and other items owned by the disputant.

The disputant transferred funds to New Zealand to meet the Trust's outgoings and other expenses by transferring a portion of his US dollar salary into his Hong Kong dollar account with a "salary" notation. These funds were then transmitted from this account to the Trust's bank account in New Zealand.

In 2006, the Trust purchased 29 Brown Road. This property was tenanted until June 2009. This house was then demolished and a new home was built and completed in mid-2010. Around this time, 27 Brown Road was tenanted and the disputant and his wife moved into 29 Brown Road. 27 Brown Road was eventually sold in October 2014.

The disputant had previously filed New Zealand income tax returns returning his salary. However, for the income years ended 31 March 2005 and 31 March 2006 the disputant filed nil income tax returns. In the year ended 31 March 2007 he filed a non-resident tax return disclosing a small loss for the year and in the years ended 31 March 2008 and 31 March 2009 he filed non-resident tax returns.

In the tax years in dispute, the disputant also had foreign investment fund (FIF) interests. In particular, the disputant was and continues to be a member of his employer's superannuation scheme which is funded by contribution from his employer.

The Commissioner of Inland Revenue ("the Commissioner") assessed on the basis that the taxpayer was a New Zealand resident for tax purposes and therefore was liable for income tax. The taxpayer disputed those assessments.

Decision

The Authority dismissed the disputant's challenge.

Permanent place of abode

The Authority confirmed that the test in *Diamond* (*Diamond* at [49]) was relevant and noted that the factors referred to by the Court of Appeal were not intended to be exclusive. Some factors may be more applicable than others, and what is required is an integrated and factual assessment in determining the nature and quality of the use the taxpayer habitually makes of a particular abode.

The Authority agreed with the Commissioner's approach in examining these factors and adopted that analysis.

In summary the disputant despite his extended periods at sea was found to have maintained an on-going and close association with 27 Brown Road over many years.

His salary was used to meet the Trust's loan obligations, pay insurances, utilities and other expenses. Vehicles belonging to the disputant, his wife and the Trust were registered to 27 Brown Road and he maintained SKY subscription for use when at the property. This address was used by the disputant for mail including mail related to the Trust's rental properties. The disputant's payslips were also addressed to 27 Brown Road when he was not at sea. The disputant was also registered on the Electoral Roll at this address in 2008. Credit card expenses in periods when the disputant resided at 27 Brown Road for everyday purchases were consistent with being resident at that location.

27 Brown Road was largely available for the disputant's use apart from one occasion in 2004 when the disputant and his wife did not return to New Zealand for a lengthy period. During this time there was a house sitter who paid a peppercorn rental. Otherwise the property was not rented and friends and family stayed at the property on occasion. Apart from their absence in 2004 the Authority found that there was no particular change in pattern of usage of the property over this period.

FIF Income

The disputant contended that the cost of his FIF investments did not exceed the statutory de minimis because his employer incurred the costs in relation to the superannuation scheme. The Authority considered that the de minimis exception was not restricted to cost or expenditure incurred by the person (or by the party acting as agent for that person) and that contributions made by the disputant's employer to the superannuation fund on his behalf were intended to be included within this definition. The Authority noted that on the disputant's interpretation a taxpayer could avoid the application of the FIF rules so that contributions made by an agent of the taxpayer had no cost is artificial and contrived as these clearly formed a part of his salary package.

Timebar/process issues

Having found the disputant to be a New Zealand resident for tax purposes in the tax years in dispute, it followed that the disputant had failed to disclose income and therefore grounds existed under s 108 (2)(a) of the Tax Administration Act 1994 ("TAA") for the Commissioner to amend the time-barred assessments.

The Authority was satisfied that the requisite opinion had been formed under s 108(2) and that it is not necessary that the same person that holds the requisite opinion makes the amended assessments. Following the decision in *Edwards v Commissioner of Inland Revenue* [2016] NZHC 1795, Judge Sinclair was satisfied that even if there was any invalidity in the forming of that opinion and/or in the process of exercising the power to amend the assessments under this subsection (which she did not accept), she considered that such matters are "cured" by the de novo hearing before the Authority who must reach its own conclusion.

Shortfall penalties

In weighing up all relevant factors, the Authority found that the disputant, having failed to meet the standard of being "about as likely as not to be correct", was liable for shortfall penalties under s 141B of the TAA for taking an unacceptable tax position in relation to the years in dispute (reduced by 50% for previous behaviour under s 141FB).

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