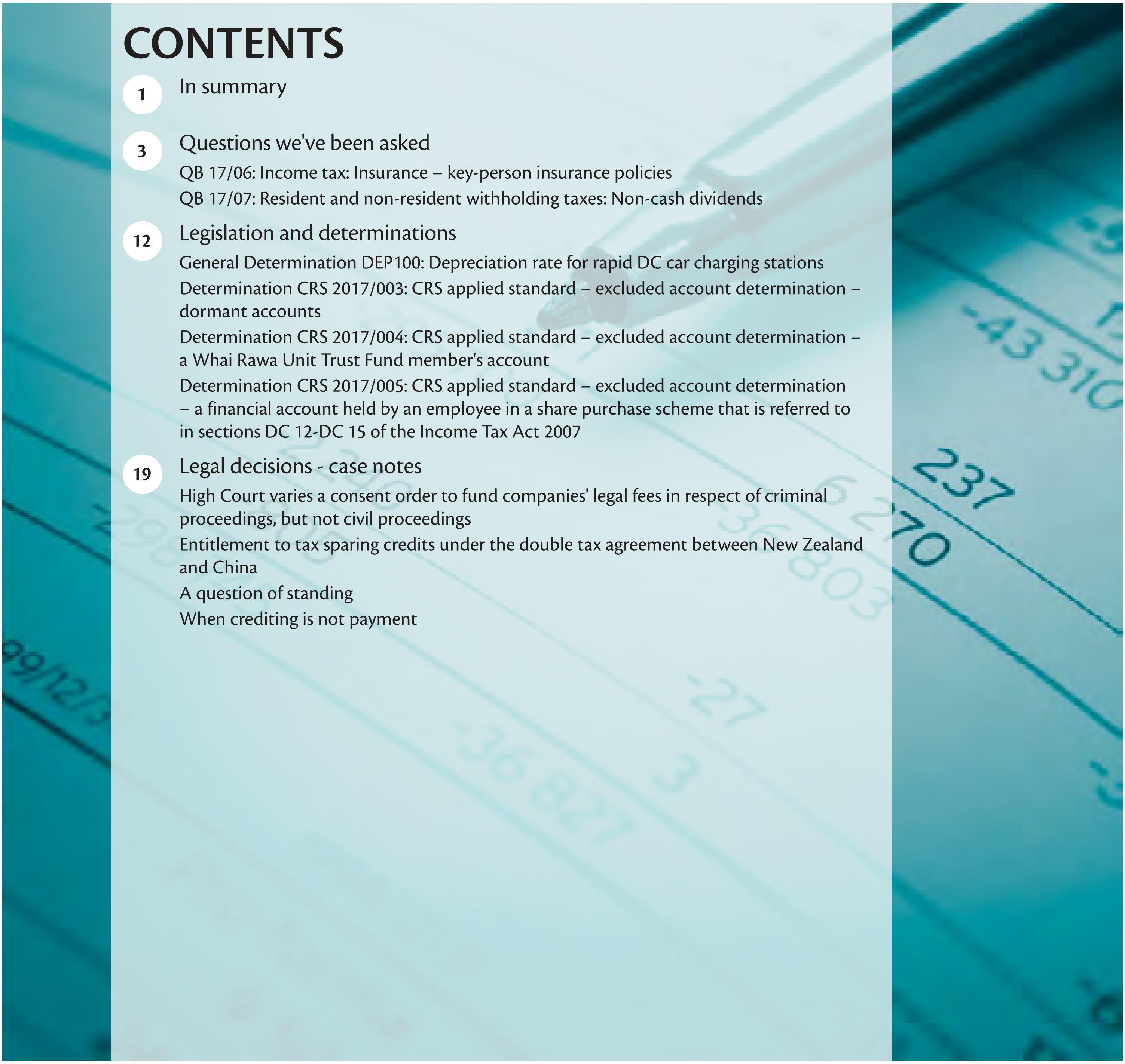
Vol 29 No 7 August 2017

TAX INFORMATION Bulletin



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Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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
ED0197	Standard practice statement	Six-monthly GST return filing	18 August 2017
ED0198	Standard practice statement	Loss offset elections between group companies	18 August 2017
ED0199	Standard practice statement	Elections to change a balance date	25 August 2017

IN SUMMARY

IN SUMMARY

Legal decisions - case notes (continued)

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 17/06: Income tax: Insurance – key-person insurance policies

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

This Question We've Been Asked is about ss CA 2, CB 1, CG 5B, DA 1, DA 2(1) and DA 2(3).

Question

1. What is the income tax treatment of payments made or received under a term life or an illness/disability insurance policy where:
    - the policy holder and recipient of any claim amount received under the policy is a business that employs staff;
    - the premium amounts are paid by the business;
    - the insured person is an employee of the business ("the key-person");
    - the employee has no enforceable or implied right against the employer to receive the claim or part thereof; and
    - the policy is taken out to compensate for a loss of business profits that would result from the death or incapacitation of the key person, whether or not the loss is accurately estimated?

    This type of insurance policy is commonly referred to as a "key-person insurance" policy and includes policies that cover total permanent disability, personal sickness and accident ("disablement policies").

Answer

2. A lump sum or a periodic sum paid under the policy is taxable income of the employer under s CB 1 (business income).
3. Premium amounts paid are deductible under s DA 1.
4. This QWBA covers key-person insurance policies to the extent that the policy is taken out to compensate for a loss of business profits that would result from the death or incapacitation of the key person. Insurance policies can be taken out for reasons other than, or in addition to, this loss of business profits purpose (eg, mortgage repayment protection, and collateral for capital funding). To the extent the insured amount is for replacement of capital, the claim amount portion that relates to the replacement of capital will not be taxable income. Where a policy is not solely to replace a loss of profits, apportionment of the premiums and/or claim amount may be required.
5. Fringe benefit tax (FBT) does not apply.

Explanation

6. Inland Revenue has reviewed all *Public Information Bulletins* (see **http://www.ird.govt.nz/technical-tax/pib-review/**). During this review, two items on the income tax treatment of insurance in an employment context were identified as being out of date. The two items are "Staff insurance schemes" (*Public Information Bulletin* No 70 (December 1972): 11) and "Life and accident insurance policies" (*Public Information Bulletin* No 106 (July 1980): 2). These PIBs covered a number of different scenarios. We are replacing the PIBs with a series of Questions We've Been Asked (QWBAs) covering common scenarios.
7. PIB 106 dealt with policies where the premiums were paid by the employer and proceeds were payable to the employer. Key-person insurance has these features. The PIB item noted that the tax treatment depended on what the insurance was for. This QWBA is considering the tax treatment of payments made or received under a key-person insurance policy for the replacement of loss of business profits.
8. Many businesses (including sole traders or partnerships) have a key employee who has a unique set of skills and/or knowledge, and is vital to the business's continued success. Should something happen to that employee, the loss of that employee will have a detrimental impact on the profitability of the business or generate financial strain. The employer may choose to protect the business from this risk by taking out a key-person insurance policy on the life and/or disablement of

that key employee. This item covers policies where the purpose of the employer in taking out the policy is to obtain cover that provides revenue replacement to that employer in the event of a key person's death or disablement due to illness or accident. The disablement could be either temporary or permanent. The claim amount can be received as a lump sum (as in the case of death or permanent disablement) or as periodic payments where the incapacity is temporary. This item does not apply to business owners such as a sole trader who takes key person insurance out on themselves (see paragraph 11 below).

9. The features of a key-person insurance policy covered by this QWBA are:
    - the business (the employer) is the policy owner and the recipient of any amounts received under the policy (ie, the beneficiary);
    - the employer pays the premiums;
    - the employer is the only party eligible to make a claim under the policy;
    - the policy is either a term life or a disablement insurance policy or a combination of both;
    - the insured person is an employee;
    - the policy is taken out to compensate for a loss of business profits (either due to a reduction in turnover or an increase in costs) that would result from the death or extended incapacity (due to illness or accident) of the key employee, whether or not the loss is accurately estimated;
    - the employee has no enforceable or implied right against the employer to receive the claim or part thereof; and
    - the claim amount is an agreed amount that may be paid as a lump sum or by periodic payments to the employer.
10. A number of other insurance policies also address types of financial loss suffered by a business (eg, business interruption). The type of key-person policy covered by this QWBA insures against an event involving the personal health (or death) of a key employee. Whereas a business interruption policy insures against financial loss triggered by physical damage to the business's operations caused by an event such as fire, earthquake or cyclone. Business interruption policies do not have a life insurance component to them.
11. The type of key-person policy covered by this QWBA is also distinguishable from an income protection policy because it protects the income of the business (employer), whereas income protection policies provide protection for the income of the insured person (eg, income of the employee or sole trader). Business interruption and income protection policies are not covered in this QWBA. Also this item does not cover whole of life or endowment policies as we understand that these types of policies are no longer commonly used in this context.

Income tax treatment of the claim amount

12. An employer can receive an amount of money from an insurer on the occurrence of the insured event, referred to as the claim amount.
13. An amount derived from a business is income (s CB 1(1)). Capital amounts are excluded from taxable income (s CB 1(2)). Whether a claim amount received is income or capital depends on whether it is compensating for a loss of a capital or revenue nature (*Egmont Co-operative Dairies Ltd (in liq) v CIR* [1996] 2 NZLR 419 (1996) 17 NZTC 12,536, *Carapark Holdings Ltd v FCT* (1967) 115 CLR 653).
14. Insurance claim amounts that are received to "fill the hole of" or replace lost business profits are generally considered to be business income in nature. Richardson P in *Egmont* (quoting Kitto, Taylor and Owen JJ in *Carapark*) stated:

    > In general, insurance moneys are to be considered as received on revenue account where the purpose of the insurance was to fill the place of a revenue receipt which the event insured against has prevented from arising, or any outgoing which has been incurred on revenue account in consequence of the event insured against, whether as a legal liability or as a gratuitous payment actuated only by considerations of morality or expediency.
15. Similarly, in *CIR v Soma President Textiles Ltd; CIR v New Zealand Knitting Mills Ltd* (1994) 16 NZTC 11,313, McGechan J stated (at 11,321):

    > ... It is well recognised that the character of a compensation receipt-as capital or income-is coloured by the character of the item it compensates. Compensation for capital assets is capital: for income items, is income....

    See also *Burmah Steam Ship Co Ltd v IRC* (1931) 16 TC 67 and *London & Thames Haven Oil Wharves Ltd v Attwooll* [1967] 2 All ER 124,134.

16. The Courts have confirmed that income derived under a policy insuring a key-person will generally be revenue in nature (see *Gray & Co Ltd v Murphy* (1940) 23 TC 225 (KB), *Executors of Williams v IR Commissioners* (1924) 26 TC 23 (HL), *Keir & Cawder v Commissioners of Inland Revenue* (1958) 38 TC 23 (Court of Session), and *Carapark*). In *Keir & Cawder*, Lord President Clyde summarised this principle as follows:

> In the ordinary case where a company insures the life of an employee whose services are valuable to them, the sum received by the company on his death is a revenue reciept: see *Commissioners of Inland Revenue v Williams's Executors*, 26 T.C. 23; for the expenditure incurred by the company in securing and retaining his services is a proper revenue charge, and the benefits derived from these services, being reflected in the profits of the company, are also of a revenue character. In the ordinary case, therefore, if the company insures the life of that person and on his death receives a payment from the insurance company, that payment represents compensation to the company for the loss of his services in helping them to earn profits and is a receipt on revenue account.

17. As key-person insurance amounts replace taxable business profits they will also be taxable income under the Act. However, if the claim amount replaces a capital component, that component of the claim amount would be capital for tax purposes.

18. If the income that is being replaced by the claim amount is exempt or excluded income (s CA 2) then the claim amount will also be exempt or excluded income in the same manner as the income it replaces.

19. Section CG 5B is a specific provision that taxes certain receipts for interruption or impairment of business activities. In an insurance context it taxes insurance payments received **for** an interruption or impairment of business activities resulting from an event. If the key-person insurance policy includes payments that are contingent on the taxpayer proving an actual loss of income, these payments are likely to be taxable under s CG 5B and subject to the timing provision in s CG 5B(3).

Deductibility of premiums for employer

20. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving taxable (and/or excluded) income (s DA 1). It is also necessary that the deduction is not denied by the general limitations contained in s DA 2.

21. As set out above, insurance recovery amounts under key-person insurance policies will generally be revenue in nature (see *Egmont*; *Carapark*). Where that is the case, the payment of a premium intended to insure against the lost taxable income will satisfy the nexus test in s DA 1. The capital limitation in s DA 2(1) will not apply because the premiums are a regular expense outlaid as part of the regular demands on the income of the business.

22. There will, however, be situations where premiums will not be deductible, either because the expenditure will not satisfy the general permission in s DA 1, or because one or more of the general limitations in s DA 2 will apply. For example, the Commissioner considers that premiums will not be deductible in the following situations:
    - Where the employer takes out a policy for the purpose of securing the ability to repay a loan. In this situation, the capital limitation will apply.[1]
    - Where the employer takes out a policy on behalf of its shareholders in order to buy out a shareholder's estate in the event one of them dies. In this situation, the benefit accrues to the shareholders, rather than to the company itself. Therefore, the general permission will not be satisfied.

23. Where a policy is not solely to replace a loss of profits, apportionment of the premiums and/or claim amount may be required.

24. The taxpayer has the onus of proving that an insurance premium is deductible. Therefore, it will be necessary to regularly review the purpose of a policy to determine deductibility of the premium, consistent with the principles of self-assessment.

Fringe Benefit Tax

25. For the avoidance of doubt, there is no benefit provided to an employee in connection with the key person insurance policies covered in this QWBA. This means no fringe benefit tax applies.

[1] The Commissioner has also confirmed that a deduction will not be allowed under s DB 5 where the insurance has a primary purpose of ensuring repayment obligations can be met (see "Deductibility of expenditure incurred in borrowing money – section DB 5" Interpretation statement IS 13/03 (*Tax Information Bulletin* Vol 26, No 1 (February 2014):3)).

Examples

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

Example 1 – Purpose is only for loss of profits

27. ABC Ltd relies heavily on its top salesperson, Bob Adams. ABC Ltd is concerned that if something happened to Bob, the company would suffer a significant loss of profits. It estimates its potential loss of profits would be at least $400,000. To help manage this risk, ABC Ltd takes out a key-person insurance policy. Features of the policy are:
    - Bob Adams is the life insured;
    - the policy document describes the policy benefits as a "term life insurance policy" and names ABC Ltd as the policy owner;
    - ABC Ltd is contractually bound to pay the monthly premiums;
    - the insurer will pay out to ABC Ltd on death, or on total permanent disablement of Bob, or pay a monthly benefit based on expected losses suffered if Bob is temporarily unable to work.
28. A claim amount of $400,000 is payable as a lump sum on death or total permanent disablement. A lesser amount is payable for partial disablement. Alternatively for temporary incapacity, a monthly benefit ($12,500 per month payable in monthly instalments for a maximum of 24 months) will be paid to ABC Ltd until either Bob can return to work or is no longer employed by ABC Ltd.
29. The value of the claim amount and the value of the monthly benefit amounts have been determined with reference to ABC Ltd's historical financial results.
30. ABC Ltd wants to know whether it can deduct the premiums that it pays on the policy. ABC Ltd is allowed a deduction for the premiums paid as they are a cost incurred by them in deriving taxable income (s DA 1).
31. Unfortunately the following year, Bob is killed in a car accident and ABC Ltd receives the $400,000 claim amount shortly after this event.
32. ABC Ltd wants to know whether the claim amount is taxable.
33. The claim amount is taxable under s CB 1. The purpose of the policy is *to ensure ABC Ltd does not suffer a loss of business profits* due to Bob being unable to contribute to the business's profitability. As the amount of $400,000 received from the insurer is intended to replace business profits, it will be taxable income under s CB 1(1).
34. If Bob had been only injured in the car accident, ABC Ltd would suffer a temporary loss of business profits. In that case, ABC Ltd would receive a monthly benefit. The monthly benefit amounts would also be taxable income under s CB 1.

Example 2 – Multiple purpose key-person policy

35. Quick Growth Ltd relies heavily on its chief programmer, John Jones. Five years ago when the company began Quick Growth Ltd was concerned that if something happened to John, the company would suffer a significant loss of profits. To help manage this risk Quick Growth Ltd took out a key-person insurance policy for $500,000. The features of the policy were identical to ABC Ltd's policy (above).
36. Because Quick Growth Ltd has expanded rapidly they are reassessing their insurance requirements. In addition, Quick Growth has applied for a loan from the bank. The bank has indicated they will accept the key-person insurance policy will meet their requirement for mortgage repayment insurance. Quick Growth Ltd decides they now require $600,000 to cover the loss of profits risk but also require an additional $400,000 cover to satisfy the bank's requirements.
37. Quick Growth Ltd wants to know if it can claim the premiums it pays on the policy. Quick Growth Ltd is allowed a proportional deduction for the premiums paid based on the ratio of the insured amount relating to the loss of profits/total insured amount (eg, $600,000/$1,000,000 = 60%). The remaining 40% of the premium is subject to the capital limitation in s DA 2.
38. Six months later John has a heart attack and dies. Quick Growth Ltd receives the $1,000,000 claim amount shortly after this event.
39. Quick Growth Ltd wants to know whether the claim amount is taxable.
40. The claim amount of $600,000 for loss of profits is taxable (s CB 1). The purpose of this amount was to replace business profits due to John being unable to contribute to the business's profitability. The balance is not taxable. As the amount of $400,000 is intended to replace capital repayments it will not be taxable under s CB 1(1).

References

Related rulings/statements

"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2

"Deductibility of expenditure incurred in borrowing money – section DB 5" Interpretation Statement IS 13/03 (2013) *Tax Information Bulletin* Vol 26 No 1 (February 2014)

"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11

QB 15/05 Term life insurance taken out by employee with employer paying the premiums on employee's behalf (TIB Vol 27, No 6 (July 2015))

QB 15/06 Term life insurance policy taken out by employer for the benefit of an employee (TIB Vol 27, No 6 (July 2015))

QB 15/09 Personal sickness and accident insurance taken out by employee with employer paying the premiums on employee's behalf (TIB Vol 27, No 10 (November 2015))

QB 15/10 Personal sickness and accident insurance taken out by employer for the benefit of an employee (TIB Vol 27, No 10 (November 2015))

Subject references

Income protection insurance

Life insurance

Personal Illness or Disability insurance

Legislative references

Income Tax Act 2007 – ss CA 2, CB 1, CG 5B, DA 1, DA 2(1) and DA 2(3)

Case references

Burmah Steam Ship Co Ltd v IRC (1931) 16 TC 67

Carapark Holdings Ltd v FCT (1967) 115 CLR 653

CIR v Soma President Textiles Ltd; CIR v New Zealand Knitting Mills Ltd (1994) 16 NZTC 11,313

Gray & Co Ltd v Murphy (1940) 23 TC 225 (KB)

Egmont Co-operative Dairies Limited (in liq) v CIR (1996) 17 NZTC 12,536

Executors of Williams v IR Commissioners (1924) 26 TC 23 (HL)

Keir & Cawder v Commissioners of Inland Revenue (1958) 38 TC 23 (Court of Session)

London & Thames Haven Oil Wharves Ltd v Attwooll [1967] 2 All ER 124,134

Other references

http://www.ird.govt.nz/technical-tax/pib-review/

QB 17/07: Resident and non-resident withholding taxes: Non-cash dividends

Notes

In the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill introduced to Parliament on 6 April 2017 it is proposed to amend:

- s CD 15 (Tax credits linked to dividends) to confirm that a non-cash dividend includes any resident or non-resident withholding tax paid for that dividend; and
- s LB 3 (Tax credits for resident withholding tax) to confirm that, when determining tax withheld and paid, a person's resident passive income includes resident withholding income for a non-cash dividend.

This QWBA sets out the Commissioner's view that these amendments to the Income Tax Act 2007 confirm the existing treatment of resident and non-resident withholding tax as explained below.

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

This Question We've Been Asked (QWBA) is about ss RE 14 and RF 10.

Question

1. Does the income of a person receiving a non-cash dividend include any resident or non-resident withholding tax paid on the dividend?

Answer

2. Yes.
3. This means a recipient of a non-cash dividend has income comprising the amount of the non-cash dividend determined under s CD 38 and any resident or non-resident withholding tax paid for that dividend.

Explanation

4. This question arises because, unlike a cash dividend where tax is withheld from the dividend income, with a non-cash dividend withholding tax must be paid in addition to the dividend income.

Resident withholding tax

5. In certain situations, the Act requires a person who is paying a dividend to another person to withhold some of the payment and pay it to the Commissioner as resident withholding tax (RWT). The person receiving the payment can usually offset the RWT as a credit against their tax liability for the payment, and receive a refund of the RWT in certain circumstances.
6. For RWT to apply, the payment must be "resident passive income" as defined in the Act (also known as "resident withholding income" in earlier Acts). Relevantly, "resident passive income" includes dividends whether paid in money (cash dividends) or not paid in money (non-cash dividends). Generally, any transfer of value by a company to a shareholder caused by the shareholder relationship is a dividend. A non-cash dividend is a dividend if it does not consist of an unconditional payment in money or a credit to the balance of a shareholder's current account (or similar account) with the company. Non-cash dividends are considered to be "paid" (in terms of the RWT provisions), as the Act defines an "amount" as including "an amount in money's worth" and it defines "pay" as including where any "amount" is distributed or credited to a person, or otherwise dealt with in their interest.
7. One example of a non-cash dividend is an in-kind (or "in-specie") distribution where property of the company is transferred to a shareholder for no consideration. Another example of a non-cash dividend is a taxable bonus issue. A further example is where there is a deemed dividend under the Act, such as when company property (eg, a company car) has been provided for a shareholder's private use and insufficient consideration has been provided for that use. Generally, this is where the shareholder is not an employee.[1]
8. The amount of a non-cash dividend taken into account for the RWT rules is the market value of what the recipient receives less any consideration the recipient provides in return (see s CD 38).

[1] Where the shareholder is also an employee, non-cash benefits like the provision of a vehicle will generally be a fringe benefit rather than a dividend. Section CX 17 allows companies to elect some non-cash benefits to be treated as dividends instead of fringe benefits. This option does not apply to "unclassified benefits" such as vehicle-related benefits or loans which are treated as fringe benefits.

9. With cash dividends, s RA 9 makes it clear the gross dividend including the RWT is income of the recipient. Section RA 9 states the recipient derives the RWT "for the purposes of the Act" in the same way they derive the underlying payment.

10. This QWBA confirms the Commissioner's view that the same result arises for non-cash dividends. That is, the recipient's income from a non-cash dividend includes the RWT paid for the dividend. However, this is not clearly stated in the Act. The lack of clarity has led to doubt over whether a non-cash dividend is "grossed up" to include RWT.

11. Practically, it is not possible to withhold RWT from non-cash dividends as they are not paid in money. This means RWT cannot be "withheld" using the same legislative approach used for cash dividends. The Act must provide separately for RWT on non-cash dividends. It does so principally through s RE 14.[2]

12. Section RE 14 requires a person paying a non-cash dividend to calculate and pay RWT using a formula based on the "amount" of the non-cash dividend (as per s CD 38). In this situation, unless the Act treats the RWT as the recipient's income, their income would be limited to the amount of the non-cash dividend as determined under s CD 38.

13. Although s RE 14(4) treats the RWT "as if it were the amount of tax required to be withheld and paid under the RWT rules", this is only for the calculation in s RE 14(2). Section RE 14 does not treat the RWT calculated under the provision as an amount of RWT withheld for all purposes of the Act.

14. Because there is no amount "withheld", it is unclear whether s RA 9 (as discussed above in paragraph 9) applies to RWT calculated under s RE 14. No other provision matching s RA 9 applies to non-cash dividends. Also, subpart CD of the Act (income arising from equity) does not specifically refer to the RWT calculated under s RE 14 as income of the recipient.

15. Any lack of clarity has only arisen since the Income Tax Act 2007 replaced the Income Tax Act 2004. However, the provisions of the Income Tax Act 2007 are intended to have the same effect as the Income Tax Act 2004. Where there is any lack of clarity in the Income Tax Act 2007 it is appropriate to consider the corresponding provisions in the Income Tax Act 2004 (see s ZA 3(4) of the Income Tax Act 2007).

16. Under the Income Tax Act 2004 (and earlier income tax legislation), it was clear the recipient's income included any RWT paid on non-cash dividends. In those Acts, RWT payable on a non-cash dividend was deemed to be a deduction of RWT for all purposes of the Acts (see s 327C(2) of the Income Tax Act 1976 and ss NF 2(2) of the Income Tax Act 1994 and 2004). The Commissioner's view of the issue under the 1976 Act is illustrated by the example at page 15 of *Tax Information Bulletin* Vol 3, No 7 (April 1992) where the recipient of a non-cash dividend ("Co. A" in example 2) is stated to derive an amount of income that includes the RWT. There is no identified change to the former s NF 2(2) in the Income Tax Act 2007 (see schedule 51 of the Act).

17. In addition, an inappropriate result could arise if the RWT paid for a non-cash dividend is not an amount of "tax withheld" for all purposes of the Act. Then, a tax credit would not be allowed for the RWT. This is because under s LB 3(1) a person has a tax credit equal to the "tax withheld" and paid in relation to their resident passive income. If no tax credit was allowed the result could be double taxation. Double taxation is where the same person is taxed twice on the same income. An interpretation that results in double taxation should not be adopted unless it is beyond any doubt that it was intended (see *Canadian Eagle Oil Co Ltd v R* [1945] 2 All ER 499 (HL); *C of T v Luttrell* [1949] NZLR 823 (CA)).

18. For example, with a non-cash dividend of $100, RWT of $49.25 would be paid to the Commissioner on behalf of the recipient of the dividend. Despite this tax payment on their behalf, the recipient could pay tax again for the same dividend if they could not claim a tax credit.

19. An inappropriate result would also arise if RWT on a non-cash dividend was treated as an amount withheld for the purpose of the tax credit provisions but not for the purpose of calculating the recipient's income. In that case, a mismatch arises between the recipient's income and the tax credits that can be offset against tax payable on the dividend income. For example, the RWT on a $100 cash dividend is $33. The recipient's income is $100 and the tax credit available to them for the RWT is consistent with the RWT tax rate of 33%. In contrast, the RWT on a $100 non-cash dividend is $49.25. If the recipient's income was only $100, the tax credit available to them is inconsistent with the RWT tax rate. However, the tax credit is consistent with the 33% RWT tax rate if the recipient's income is $149.25 (ie, $149.25 @ 33% = $49.25).

20. Finally, the Act defines "resident passive income" as including both dividends and the RWT paid for them. Arguably, it follows that for the purposes of the Act, dividend income includes the RWT (whether deducted from, or paid in addition to, the dividend). With cash dividends or interest, RWT is paid out of the income. RWT paid for non-cash dividends is an additional payment and an additional transfer of value from the payer to the recipient. It is appropriate to treat this

[2] Non-cash dividends that are either "bonus issues in lieu" or "a share issued under a profit distribution plan" are dealt with in a similar way under s RE 15 and the conclusions in this QWBA apply equally to those types of non-cash dividends.

additional amount as income of the recipient and it is consistent with amendments made by the *Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017* (ss 267–268) to allow non-cash and cash dividends paid together to be treated for RWT purposes as a single dividend. It also avoids the inappropriate results mentioned above.

Non-resident withholding tax

21. A similar issue to that discussed above for RWT arises for non-resident withholding tax (NRWT). As with RWT, in certain situations the Act requires a person who is paying a dividend to a person who is not a tax resident to withhold some of the payment and pay it to the Commissioner as NRWT. For this to occur, the payment must be "non-resident passive income" as defined in the Act (also known as "non-resident withholding income" in earlier Acts). As with "resident withholding tax", non-cash dividends can be "non-resident passive income".

22. Section RF 10 applies NRWT to non-cash dividends. The formula operates to gross up the dividend in the same way as the RWT formula in s RE 14. For example, a $100 non-cash dividend attracts $42.86 NRWT using a 30% tax rate (ie, the dividend is treated as equivalent to a $142.86 cash dividend).

23. Non-resident passive income comprising dividends is also "schedular income" (see paragraph (f) of the s YA 1 definition "schedular income" and s RF 2(3)(a)). A person's tax liability for schedular income is calculated separately from other income under s BC 7. Section RF 2(4) applies to dividends and provides that if the dividend recipient is a filing taxpayer, their schedular tax liability under s BC 7 for the dividend is "determined by the amount of tax required to be withheld" (ie, the tax liability equals the NRWT paid). This makes the NRWT a final tax on the dividend and effectively means the non-resident recipient's income has been assessed as including the NRWT (ie, $142.86 using the $100 non-cash dividend example above).

24. A "filing taxpayer" is essentially any person who is not a "non-filing taxpayer" (see s YA 1 definitions). A "non-filing taxpayer" includes a person who only derives non-resident passive income in the year. So a person who is a non-resident who only received dividend income will be a non-filing taxpayer. Section RB 3(2) provides a non-filing taxpayer's terminal tax is their schedular income tax liability calculated using the formula:

    amount of income × tax rate.

25. For this calculation to give the same amount of terminal tax liability as the NRWT paid, the "amount of income" must include the dividend plus the NRWT paid for the dividend. Accordingly, the Commissioner's view is that the "amount of income" in s RB 3(2) includes **any NRWT paid** for the dividend income. If this was not the case, a non filing taxpayer's tax liability for a $100 non-cash dividend would be $30 despite the $42.86 NRWT paid. This would be a similar anomalous result as noted above with RWT if the withholding tax is not treated as income along with the dividend.

Example

26. As shown, for tax purposes the income of recipients of non-cash dividends varies according to whether the dividend is subject to withholding tax. Companies providing non-cash dividends may need to consider if this unequal outcome has any implications for non-tax related legislation. One approach may be to pay an additional compensating payment to equalise the distributions to shareholders.

Facts

A New Zealand resident company has four equal shareholders: three are New Zealand tax residents and one is not a tax resident. Two of the three New Zealand resident shareholders are exempt from RWT.

The company pays a non-cash dividend by distributing to its shareholders shares the company holds in another company. Each shareholder receives 100 shares with a current market value of $10 each. The shareholders provide no consideration to the company in return so the amount of the dividend paid is $1,000. No imputation credits are attached to the dividends.

RWT for the resident shareholders

Where an RWT liability arises, the formula in s RE 14(2) applies as follows:

(tax rate × dividend paid ÷ (1 – tax rate)) – tax paid or credit attached

(0.33 × $1,000 ÷ (1 – 0.33)) – 0 = $492.53

Where the dividend is subject to RWT, shareholders' income is $1,492.53 ($1,000 + $492.53).

Where the dividend is not subject to RWT, the shareholders' income is $1,000.

NRWT for the non-resident shareholder

Where a NRWT liability arises, the formula in s RF 10(2) applies as follows:

(rate A ÷ (1 – rate A) × dividend payment)[3]

Where:

rate A = 0.3 (the tax rate set out in s RF 8)

dividend payment = $1,000 (the amount of the dividend to the extent it is not fully imputed)

(0.3 ÷ (1-0.3) × $1,000) = $428.57

Comment

As this example shows, companies may need to consider the differing results arising for shareholders when deciding to pay non-cash dividends. In this case, the company may wish to consider whether to make compensating payments to equalise the distributions to shareholders.

Comparison with cash dividends

In comparison, if the dividend in this example was a cash dividend and RWT or NRWT applied, the withholding tax would be deducted from the cash payment to the shareholders (ie, no additional amount would be paid by the company on the shareholders' behalf as RWT or NRWT).

This means the income of all shareholders is $1,000 regardless of whether RWT or NRWT applied to the dividend. Assuming the dividend is taxable to a shareholder, depending on whether withholding tax applied or not, a shareholder either receives an after-tax amount from the company or has to fund any tax due on that dividend themselves.

References

Subject references
Non-cash dividend
Non-resident withholding tax
Resident withholding tax
Schedular income

Legislative references
Income Tax Act 1976: s 327C(2)
Income Tax Act 1994: s NF 2(2)
Income Tax Act 2004: s NF 2(2)
Income Tax Act 2007 – ss BC 7, LB 3, CD 15, CD 38, CX 17, RA 9, RB 3, RE 14, RE 15, RF 2, RF 8, RF 10, YA 1

Case references
Canadian Eagle Oil Co Ltd v R [1945] 2 All ER 499 (HL)
C of T v Luttrell [1949] NZLR 823 (CA)

Other references
Tax Information Bulletin Vol 3, No 7 (April 1992):15

[3] This is the formula following amendment by s 277 of the Taxation (Annual Rates for 2016-17, Closely Held Companies and Remedial Matters) Act 2017.

LEGISLATION AND DETERMINATIONS

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

General Determination DEP100: Depreciation rate for rapid DC car charging stations

Note to Determination DEP100

The Commissioner has set a general depreciation rate for a new asset class "Rapid DC car charging stations", not currently provided for under the "Transportation" asset category, within the Commissioner's Table of Depreciation Rates.

Electric vehicles have a charger built in that converts the domestic alternating current (AC) into direct current (DC) for the car's battery. This onboard charger generally takes around 6-8 hours to fully charge a car. A rapid charger is a much larger, freestanding version than the onboard charger. It bypasses the vehicle's onboard charging device and supplies power directly to the vehicle's battery. It converts high power 3-phase AC into DC and significantly reduces the charging time – usually to less than 30 minutes.

Determination DEP100: Tax Depreciation Rates General Determination Number 100

1. Application

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

This determination applies for the 2017 and subsequent income years.

2. Determination

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

- Adding into the "Transportation" asset category, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Rapid DC car charging stations	10	20	13.5

3. Interpretation

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

This determination is signed on the 15th day of June 2017.

Rob Wells
Manager, LTS Technical Standards

Determination CRS 2017/003: CRS applied standard – excluded account determination – dormant accounts

Reference

This determination is made under section 91AAW of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Group Manager, Investigations and Advice, under section 7 of that Act.

Interpretation

In this determination, unless the context otherwise requires:

"Annuity contract" means an annuity contract as defined in Section VIII(C)(6) of the CRS standard.

"Cash value insurance contract" means a cash value insurance contract as defined in Section VIII(C)(7) of the CRS standard.

"CRS applied standard" means the CRS standard as modified by section 185O for the determination of requirements under the Tax Administration Act 1994.

"CRS publication" means the *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, published by the Organisation for Economic and Cultural Development.

"CRS standard" means the *Common Standard on Reporting and Due Diligence for Financial Account Information*, as amended from time to time, which is a standard—

(a) developed by the Organisation for Economic and Cultural Development and the Group of Twenty countries; and

(b) agreed by the Council for the Organisation for Economic and Cultural Development on 15 July 2014; and

(c) contained in Part IIB of the CRS publication.

"Dormant account" means a financial account, other than an annuity contract, with an aggregate balance that does not exceed 1,000 United States dollars (USD) (which the Reporting NZFI that maintains the account can treat as 1,000 New Zealand dollars (NZD)) and that satisfies either of the following:

1. the account is treated as a dormant account under applicable laws or regulations or the normal operating procedures of the Reporting NZFI that are consistently applied for all accounts maintained by the Reporting NZFI in New Zealand, provided that such laws or regulations or such procedures contain substantially similar requirements to those set out in point 2 below; **or**
2. The account satisfies the following:
   - the account holder has not initiated a transaction with regard to the account or any other account held by the account holder with the Reporting NZFI in the previous 3 years; and
   - the account holder has not communicated with the Reporting NZFI regarding the account or any other account held by the account holder with the Reporting NZFI in the previous 6 years; and
   - in the case of a cash value insurance contract, the Reporting NZFI has not communicated with the account holder regarding the account or any other account held by the account holder with the Reporting NZFI in the previous 6 years.

"Reporting NZFI" means a reporting financial institution as defined in Section VIII(A)(1) of the CRS standard that is resident in New Zealand under the CRS standard (excluding branches located outside of New Zealand), or is a branch of a non-resident financial institution that is located in New Zealand.

Discussion (which does not form part of the determination)

The CRS commentary contemplates (at pages 190-191) that a dormant account with a balance or value that does not exceed USD 1,000 can be treated as an excluded account (during the period of the dormancy) for the purposes of the CRS standard under Section VIII, subparagraph (C)(17)(g).

Determining that a dormant account is an excluded account, and specifying this under New Zealand law, does not frustrate the purposes of the CRS standard.

Scope of determination

A dormant account, as defined in this determination, does not fully satisfy the requirements for, but has substantially similar characteristics to, a savings or investment account in subparagraph (C)(17)(b) of Section VIII of the CRS standard.

This determination is issued by the Commissioner of Inland Revenue and applies to an account that meets the definition of a dormant account, as set out above, where:

- The account is subject to regulation.

Determination

A dormant account, as outlined in the scope of this determination, is an excluded account for the period of its dormancy for the purposes of the CRS applied standard and requirements under Part 11B of the Tax Administration Act 1994, unless the Reporting New Zealand financial institution that maintains the dormant account elects not to treat the account as an excluded account. A Reporting NZFI that elects not to treat a dormant account as an excluded account will be required to carry out any required due diligence (and potential reporting) on the account for the purposes of the CRS applied standard and the requirements under Part 11B of the Tax Administration Act 1994.

Application date

This determination applies for the reporting period beginning 1 July 2017, and subsequent reporting periods under the CRS applied standard.

Dated at Wellington this 22nd day of June 2017.

Patrick Goggin
Group Manager, Investigations and Advice

Determination CRS 2017/004: CRS applied standard – excluded account determination – a Whai Rawa Unit Trust Fund member's account

Reference

This determination is made under section 91AAW of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Group Manager, Investigations and Advice, under section 7 of that Act.

Interpretation

In this determination, unless the context otherwise requires:

"AML/CFT" means anti-money laundering and countering the financing of terrorism.

"CRS applied standard" means the CRS standard as modified by section 185O for the determination of requirements under the Tax Administration Act 1994.

"CRS publication" means the *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, published by the Organisation for Economic Co-operation and Development.

"CRS standard" means the *Common Standard on Reporting and Due Diligence for Financial Account Information*, as amended from time to time, which is a standard—

(a) developed by the Organisation for Economic Co-operation and Development and the Group of Twenty countries; and

(b) agreed by the Council for the Organisation for Economic Co-operation and Development on 15 July 2014; and

(c) contained in Part IIB of the CRS publication.

"Eligible to be registered as a tribal member" means other persons or groups of persons other than registered TRONT members awaiting confirmation of TRONT registration can be admitted if approved by TRONT and subject to TRONT's terms of approval.

"FMC Act 2013" means the Financial Markets Conduct Act 2013.

"ITA 2007" means the Income Tax Act 2007.

"Ngāi Tahu Whanui" has the same meaning as in the Te Rūnanga o Ngāi Tahu Act 1996.

"Permitted withdrawal" means a withdrawal that is permitted under clause 10 of the Whai Rawa Unit Trust Fund Deed dated 6 September 2016.

"Registered as a tribal member" means any member of Ngāi Tahu Whanui who is registered as a tribal member with TRONT in accordance with the Te Rūnanga o Ngāi Tahu Act 1996.

"Register of managed investment schemes" is defined in section 6 of the FMC Act, and means the register of managed investment schemes kept under Schedule 2 of that Act.

"Retirement or pension account" means an excluded account that satisfies the requirements of subparagraph C(17)(a) of Section VIII of the CRS standard.

"RSCT" means Retirement Scheme Contribution tax.

"Savings account" means an excluded account that satisfies the requirements of subparagraph C(17)(b) of Section VIII of the CRS standard.

"TRONT" means Te Rūnanga o Ngāi Tahu, a board established by Ngāi Tahu Whanui to collectively manage assets returned to settle historic Treaty of Waitangi Settlement grievances with the Crown.

"Whai Rawa member" in relation to the Whai Rawa scheme, means a natural person who has been admitted to membership of the scheme and who is, or may become, entitled to benefits under the scheme.

"Whai Rawa member's account" in relation to a member of the Whai Rawa scheme, includes any account held by that member in the Whai Rawa scheme.

"Whai Rawa scheme" means the Whai Rawa Unit Trust Fund which is a scheme that is registered on the register of managed investment schemes as a managed fund under the FMC Act.

Discussion (which does not form part of the determination)

As outlined above, the Whai Rawa scheme is a scheme that is registered on the register of managed investment schemes as a managed fund under the FMC Act. The register is maintained by the Financial Markets Authority. In order to be included on the register, Whai Rawa must fully meet the registration requirements as set out in section 127, and other relevant provisions, of the FMC Act.

The Whai Rawa scheme was established to encourage long-term savings habits for members of the Ngāi Tahu Whanui.

A Whai Rawa member must meet the following registration requirements. They must be:

- An individual (natural person) or parent, guardian or other relation of the applicant if the applicant is a minor, provided that the person is less than 65 years at date of entry;
- Registered (or eligible to be registered) as a tribal member with TRONT; and
- Able to provide a valid birth certificate.

Whai Rawa members can make voluntary contributions into their own, or into another, Whai Rawa member's account. TRONT also matches the savings of certain members up to a maximum of currently $200 per year or an additional $100 for newborns enrolled on their first birthday.

All Whai Rawa scheme contributions are locked in until the member reaches the age of 65 years; or unless a member makes another type of permitted withdrawal in accordance with the requirements of the Whai Rawa Unit Trust Deed. The member is not able to withdraw funds from Whai Rawa for any purpose other than tertiary education, first home purchase, retirement from age 55 years onwards, for special circumstances due to significant financial hardship, or hardship due to serious illness, or due to the member's death (where amounts can be withdrawn on behalf of the member).

A Whai Rawa member's account:

- Is subject to regulation under the Financial Markets Authority Act 2011, the FMC Act 2013, the ITA 2007 and the Tax Administration Act 1994;
- Is subject to regulation under the ITA 2007 as a retirement account, with Whai Rawa administering taxation obligations on behalf of its members for RSCT payable on TRONT contributions at the individual member's personal RSCT rate, and with Māori Authority tax credits available as a subsidy (partial or full – depending on the member's marginal tax rate) against the RSCT that is payable on TRONT contributions;
- Is subject to AML/CFT procedures under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009;
- Has information reported to Inland Revenue; and
- Only allows members to make permitted withdrawals. The member is not able to withdraw funds from Whai Rawa for any purpose other than tertiary education, first home purchase, retirement from age 55 years onwards, for special circumstances due to significant financial hardship, or hardship due to serious illness, or due to the member's death (where amounts can be withdrawn on behalf of the member).

A Whai Rawa member's account has substantially similar characteristics to a retirement or pension account in subparagraph C(17)(a) of Section VIII of the CRS standard and a savings account in subparagraph C(17)(b) of Section VIII of the CRS standard, and has other substituting characteristics which indicate that such an account presents a low risk of being used to evade tax.

Determining that a Whai Rawa member's account is an excluded account, and specifying this under NZ law, does not frustrate the purposes of the CRS standard.

Scope of determination

A Whai Rawa member's account does not fully satisfy the requirements for, but has substantially similar characteristics to, a retirement or pension account in subparagraph (C)(17)(a) of the CRS standard and an investment/savings account in subparagraph C(17)(b) of Section VIII of the CRS standard.

This determination is issued by the Commissioner of Inland Revenue and applies to a member's account in the Whai Rawa scheme where:

- The Whai Rawa scheme is registered on the register of managed investment schemes as a managed fund, under the FMC Act; and
- The Whai Rawa scheme continues to maintain its registration on the register of managed investment schemes as a managed fund, and its manager complies with the relevant on-going registration requirements under the FMC Act; and
- The member of Whai Rawa is a natural person; and
- The member's annual contributions into the Whai Rawa account do not exceed United States $50,000 per annum (including any applicable aggregation rules set out in the CRS); and
- The member is not able to withdraw funds from Whai Rawa for any purpose other than tertiary education, first home purchase, retirement from age 55 years onwards, for special circumstances due to significant financial hardship, or hardship due to serious illness, or due to the member's death (where amounts can be withdrawn on behalf of the member).

Determination

A Whai Rawa member's account in the Whai Rawa scheme, as outlined in the scope of this determination, is an excluded account for the purposes of the CRS applied standard and requirements under Part 11B of the Tax Administration Act 1994.

Application date

This determination applies for the reporting period beginning 1 July 2017, and subsequent reporting periods under the CRS applied standard.

Dated at Wellington this 22nd day of June 2017.

Patrick Goggin
Group Manager, Investigations and Advice

Determination CRS 2017/005: CRS applied standard - excluded account determination – a financial account held by an employee in a share purchase scheme that is referred to in sections DC 12-DC 15 of the Income Tax Act 2007

Determination CRS 2017/005 - A financial account held by an employee in a share purchase scheme that is referred to in sections DC 12-DC 15 of the Income Tax Act 2007 is an excluded account for the purposes of the CRS applied standard and requirements under Part 11B of the Tax Administration Act 1994

Reference

This determination is made under section 91AAW of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Group Manager, Investigations and Advice, under section 7 of that Act.

Interpretation

"CRS applied standard" means the CRS standard as modified by section 185O for the determination of requirements under the Tax Administration Act 1994.

"CRS publication" means the *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, published by the Organisation for Economic Co-operation and Development.

"CRS standard" means the *Common Standard on Reporting and Due Diligence for Financial Account Information*, as amended from time to time, which is a standard—

(a) developed by the Organisation for Economic Co-operation and Development and the Group of Twenty countries; and

(b) agreed by the Council for the Organisation for Economic Co-operation and Development on 15 July 2014; and

(c) contained in Part IIB of the CRS publication.

"Employee" has the definition set out in section DC 15(1) of the Income Tax Act 2007.

"Financial account" means an account defined as a financial account in Section VIII(C)(1) of the CRS standard.

"Share purchase scheme" means a scheme referred to in sections DC 12-DC 15 of the Income Tax Act 2007, that meets the criteria set out in sections DC 13-DC 14 of the Income Tax Act 2007, and that has been approved by the Commissioner of Inland Revenue.

"Share purchase scheme account" means a financial account held by an employee in a share purchase scheme.

Scope of determination

A share purchase scheme account, as defined in this determination, does not fully satisfy the requirements for, but has substantially similar characteristics to, a savings or investment account in subparagraph (C)(17)(b) of Section VIII of the CRS standard.

Determination

A share purchase scheme account, as defined in this determination, is an excluded account for the purposes of the CRS applied standard and the requirements under Part 11B of the Tax Administration Act 1994.

Application date

This determination applies for the reporting period beginning 1 July 2017, and subsequent reporting periods under the CRS applied standard.

Dated at Wellington this 29th day of June 2017.

Patrick Goggin
Group Manager, Investigations and Advice

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

High Court varies a consent order to fund companies' legal fees in respect of criminal proceedings, but not civil proceedings

Case	Commissioner of Inland Revenue v Honk Marine Ltd and ors [2017] NZHC 1258
Decision date	9 June 2017
Act(s)	New Zealand Bill of Rights Act 1990, ss 25 and 29. Evidence Act 2006, s 47
Keywords	"Freezing orders", "legal representation", "consent orders", "variation of consent orders", "inherent jurisdiction"

Summary

Honk Marine Ltd and Honk Barges Ltd ("the Companies") applied to vary a consent order which arose from ex parte freezing orders obtained by the Commissioner of Inland Revenue ("the Commissioner"). The Companies applied to access a fund (of $2,081,861.71) held in the Court in order to pay its legal fees for both civil and criminal tax proceedings. The High Court (Brewer J) varied the consent order in respect of the criminal proceedings, but not the civil proceedings.

Impact

This case provides guidance on the civil law test for varying consent orders and what will constitute a "significant change of circumstances". The terms of the consent order expressly provided that the fund "has been preserved solely to enable payments of tax debts" and that "no other payments will be sought to be made from the Fund". The Court accepted that the Commissioner has a proprietary interest in the fund.

Facts

The Commissioner was prosecuting the Companies for tax evasion (criminal proceedings). The Commissioner has also required the Companies to challenge her default assessments of tax (which are based on the same allegations as underlie the criminal proceedings) by filing proceedings under Part VIIIA of the Tax Administration Act 1994 (civil proceedings).

The Companies' only asset was $2,081,861.71 ("the fund") held in the Court pursuant to consent orders made by Lang J on 25 June 2013. The Companies applied to access the fund to pay their legal fees in both proceedings. However, the Companies' proposed payments did not fall within the ambit of the consent orders, which clearly stated that the fund would be used solely to pay the Companies' tax debt.

Decision

Legal Principles

His Honour stated that the High Court has the inherent jurisdiction to vary or set aside a consent order if the interests of justice require it and if good grounds are established to warrant that course. "Good grounds" traditionally means "grounds that would justify setting aside a contract".

The Court stated that this case was to be considered under the inherent jurisdiction to vary the consent orders if the circumstances are extraordinary. As part of that inquiry, the Court considered whether the Companies' circumstances have changed unforeseeably.

The Court accepted that the Commissioner had a proprietary interest in the fund. The Court noted that the parties agreed to discharge the freezing orders for pragmatic commercial reasons that had advantages for both sides. The Companies could dispose of assets and, save for having to create the fund, could deal with them as they chose. The Commissioner had the fund created and set aside for her to draw on (with the permission of the Court) in the event of victory in the civil tax proceedings. This was not just a continuation of the interim position created by the freezing orders.

The Court stated that the consequence was that the threshold to be crossed before the Companies could access the fund to pay for legal representation was higher. Where assets are restrained by freezing orders, the Court will normally allow access to them to pay for legal representation. That was not the case for a fund created by consent orders.

The Court commented that if a claimant has a proprietary interest in restrained funds pursuant to consent orders, then the applicant's task will be even more difficult. The outcome depends on the facts and the Court retains its inherent jurisdiction to vary consent orders. However, the context will include the agreement of the parties that created the proprietary interest. The ultimate inquiry must always address the interests of justice. Consent orders are "not easily disturbed" and the Court will regard an application to vary them "with considerable caution".

Civil proceedings

The Court stated that the legal principles underpinning freezing orders and consent orders are quite different. A freezing order is a temporary order restraining a respondent from (broadly) dealing with assets against the claimed interests of the applicant.

The Court further stated that a consent order is very different. It gives the Court's authority to an agreement between the parties. That is why the traditional scrutiny of an application for variation is through the lens of contract. It is for the parties to set down the terms of their agreement and the Court's order gives them effect.

The Court stated that the key point was that the threshold required to be crossed before a consent order will be varied is a high one. There is a contractual underpinning to a consent order so that an applicant for a variation must show that the agreement should be set aside to the extent of the variation sought. The threshold is higher still when the terms of the consent order create a proprietary interest in favour of the respondent (in this case, the Commissioner). The purpose of the consent orders was to keep intact the fund against the Commissioner's tax assessment being upheld. That there would be costs involved must have, or should have, been within the contemplation of the parties, even if the Companies expected to pay those costs from other resources. The Court held that the Companies did not cross the threshold in respect of the legal costs in the civil proceedings.

Criminal proceedings

The Court stated that the criminal proceedings were a significant change of circumstances. There was nothing to indicate that the consent orders were made with criminal prosecutions in contemplation.

The Court further commented that the fact that the Companies are not people does not diminish their right to defend themselves (New Zealand Bill of Rights Act 1990, ss 25(a) and 29). The right to a fair trial generally includes the right to legal representation. If the Companies were to defend the charges, to have a fair trial, they must access the fund.

The Court noted that if the Companies are convicted of the offences then that would significantly, if not decisively, affect the civil proceedings. Section 47 of the Evidence Act 2006 provided that in the absence of exceptional circumstances, proof that a person has been convicted of a relevant offence is conclusive proof in a civil proceeding that the person committed the offence.

The Court held that the interests of justice required the Companies to have reasonable access to the fund to defend themselves against the criminal charges brought by the Commissioner.

Result

The Court commented that this case was an example of a rare or exceptional situation where variation of consent orders will be granted to some extent. The application for access to the fund to pay legal costs relating to the civil proceeding was denied. The application for access to the fund to pay legal costs relating to the criminal proceeding was allowed, on certain conditions.

Leave was reserved to the Companies to make further application to access the fund in the event that $100,000 is insufficient to pay costs. The Companies were on notice that if such further application is received, the Court anticipated the Commissioner being given copies of all accounts so as to be able to make submissions.

Entitlement to tax sparing credits under the double tax agreement between New Zealand and China

Case	Patty Tzu Chou Lin v Commissioner of Inland Revenue [2017] NZHC 969
Decision date	12 May 2017
Act(s)	Article 23 New Zealand/China DTA, s 138P of the TAA 1994, ss LC 4(1) of the Income Tax Act 1994, LC4(1) of the Income Tax Act 2004 and LK 1 of the Income Tax Act 2007
Keywords	Double tax agreement, Article 23 New Zealand/China DTA, controlled foreign corporation, tax sparing, tax credits, OECD Model, UN Model

Summary

This case concerns an investment held in five companies established in China ("the Chinese Companies") and the tax consequences to the plaintiff, Ms Lin, of that investment. Ms Lin was assessed by attribution for New Zealand tax on a 30 per cent share of the income derived by the Chinese Companies. Ms Lin contends that, in assessing her, the defendant, the Commissioner of Inland Revenue ("the Commissioner"), failed to allow her the full tax credits to which she was entitled under the double tax agreement ("DTA") between New Zealand and China ("the China DTA") and under the related New Zealand domestic law. The Court found that the Commissioner's assessments and default assessments in respect of Ms Lin's income tax are incorrect.

This judgment is under appeal.

Impact

The judgment provides guidance on the interpretation of Article 23 of the China DTA.

Facts

Ms Lin is a New Zealand tax resident and her income is subject to New Zealand tax, regardless of where it is sourced. The present case concerns income attributed to Ms Lin in the 2005 to 2009 tax years ("the tax years in dispute"). During those years, Ms Lin held a 30 per cent stake in two BVI companies. Because of her shareholdings in these companies, Ms Lin was considered to hold a control interest in the Chinese Companies. Each of the Chinese Companies was accordingly defined as a Controlled Foreign Corporation ("CFC") for New Zealand purposes. The income derived by the Chinese Companies was therefore attributed to Ms Lin for New Zealand purposes under the regime pertaining to CFCs.

Over the course of the tax years in dispute, Ms Lin was attributed with personal income from the Chinese Companies totalling $4.605 million. The Commissioner allowed tax credits from China of $926,968 to offset Ms Lin's New Zealand tax liability on her attributed CFC income for Chinese tax paid by the Chinese Companies in relation to that income, leaving some $869,000 due from Ms Lin.

Under Chinese domestic tax law, tax concessions were available to the Chinese Companies, so they were relieved of Chinese tax in the amount of $588,135, which would otherwise have been imposed on their incomes (tax spared). If credited against her New Zealand liability, as she asserts should be the case, Ms Lin's tax liability would have been reduced to just under $281,000. However, the Commissioner refused to allow any credit in respect of tax spared to the Chinese Companies.

Decision

DTAs

Under a DTA one country gives up some of its income taxation rights over source or residence taxation in return for which the other country gives up some of its own income taxation rights in an effort to ensure that income is taxed only once (and in some cases, to ensure it is taxed at least once).

The differing objectives of countries in entering into DTAs are reflected in the two different Model Conventions upon which most DTAs are based: The OECD Model Convention ("OECD Model") and the UN Model Convention ("UN Model"). New Zealand is a member of the OECD and generally adopts the OECD Model's provisions but also adopts aspects of the UN Model.

Many DTAs include "tax sparing" provisions, whereby a contracting country agrees to grant relief from residence tax by way of foreign tax credits with respect to source taxes which have not actually been paid (taxes which have been "spared") because of source taxation concessions provided by the other contracting country. In the absence of tax sparing provisions, an investor who takes advantage of Chinese tax concessions, reduces its tax in China but loses its foreign tax credits (in its New Zealand tax return) and pays more tax in New Zealand. The Chinese tax concessions, instead of encouraging investment in China, effectively transfers tax revenue from China to New Zealand. A tax sparing provision deems Chinese tax to have been paid as if no Chinese tax concessions existed so the investor and not the New Zealand government, gets the benefit of the Chinese tax concessions and the investment incentive stays in place. Whilst the Commentary to Article 23 of the UN Model strongly supports the inclusion of such provisions, the OECD Model does not.

The New Zealand Approach

Expert witness Robin Oliver for the Commissioner described New Zealand's underlying policy framework for international tax as a "national welfare maximisation" model meaning that New Zealand's domestic tax rules should apply the same rate of domestic tax regardless of whether the investment is made onshore or offshore. This best ensures investments made make the highest return to New Zealand. However, New Zealand recognises its ability to deny foreign tax credits is severely constrained by DTAs and other international practical and political considerations. The granting of credits for foreign tax is the international norm and a political necessity, rather than a desirable policy outcome as far as New Zealand is concerned. Mr Oliver described each Article of a DTA as being negotiated separately because each deals with a different income stream based on its legal form. Precedents are very important and once a deviation from national policy is agreed to with one country, it is hard to resist providing the same concession to other negotiating partners. A provision might have no practical effect but might be necessary for political or other reasons.

The China DTA

The Court heard that China had a firm policy of requiring tax sparing provisions in DTAs reflecting its position as a developing economy, its adherence to the UN Model, and its global positioning as a "leader of the third world". Evidence was given that New Zealand had a long-standing policy against the inclusion of tax sparing provisions in DTAs. However, by the time the China DTA was being negotiated, New Zealand had already incorporated tax sparing provisions in agreements with six other countries and was, therefore, not in a position to refuse a tax sparing agreement with China. Mr Oliver said that New Zealand would have sought a provision which was as restricted in its application as possible.

CFCs and attribution

New Zealand's statutory CFC regime came into effect from 1 April 1988, with the objective of reducing opportunities for New Zealand residents to avoid or defer New Zealand tax through the accumulation of income in foreign non-resident companies. The OECD Commentary states that CFC rules which tax "residents on income attributable to their participation in certain foreign entities" are "internationally recognised as a legitimate instrument to protect the domestic tax base".

There is no dispute that the CFC regime applied to Ms Lin. She had the necessary control and income interests. The Court noted that none of the Chinese Companies ever distributed dividends to Ms Lin.

The principles governing treaty interpretation

The Vienna Convention on the Law of Treaties 1969 ("Vienna Convention") applies to DTAs. While the ordinary meaning of the terms of a DTA is the starting point, it is also mandatory to consider the context, object and purpose of the DTA.

Where the treaty in question is a DTA based wholly or in part upon the OECD or UN Models, the Commentaries will be highly relevant in determining the correct interpretation of the treaty. Although the Commentaries are not legally binding, they are regarded as "a source from which courts of different states can seek a common interpretation".

Chinese tax paid…in respect of [CFC] income derived by a resident of New Zealand

The outcome of this issue turns almost exclusively upon the meaning of the phrase "in respect of". Ms Lin contends that tax which is paid by a CFC is "Chinese tax paid…in respect of [CFC] income derived by a resident of New Zealand". The Commissioner submits that this must mean tax which has been paid by the New Zealand resident herself, therefore excluding tax paid by the CFC. The Commissioner submitted that the CFC regime has created a different income stream which is not business income but is an income stream derived by the New Zealand owner in respect of which the New Zealand owner has not paid in China. Ms Lin submitted that the proper construction of Article 23(2)(a) is to focus on the tax not the payer and the proper construction is much wider than the approach taken by the Commissioner.

Under the CFC regime the profits of the CFC are subject to corporate tax in the home jurisdiction of the CFC whilst the same or derivative income is taxed in the hands of investors in the resident state. Two separate legal persons are taxed on the same income - one directly, the company in China, and one by attribution, the investor in New Zealand. In this way, it can be said that the CFC regime results in economic double taxation.

Paragraph 3 of the OECD Commentary on Articles 23A and 23B describes international juridical double taxation as arising in three cases. This expanded definition of juridical double taxation is helpful to the CFC analysis because CFC attributed income can be considered as income derived from, in this case, China and both China and New Zealand impose tax on that income. Taxation of CFC attributed income can be considered to fall within the definition of or be deemed to be juridical double taxation and covered by Article 23. Further support for this interpretation is found in the discussion in the OECD Commentary on Articles 23A and 23B regarding the tax treatment of partnerships. The interpretation of the partnerships discussion is critical to the interpretation of Article 23 generally. In the view of the Court, the OECD Commentary extends Article 23 to partnerships and entities which, like partnerships, are treated in different ways by contracting states and this can properly include CFCs.

The Court concluded that "Chinese tax paid ... in respect of income derived by a resident of New Zealand from sources in the People's Republic of China" includes Chinese tax paid by the CFC itself. The effect of Article 23(2)(a) of the China DTA is therefore that Chinese tax paid by a CFC must be allowed as a credit against New Zealand tax payable by Ms Lin on her CFC income.

The application of tax sparing provisions to CFC income

Unlike Article 23(2)(a), Article 23(3) refers specifically to "tax payable ... by a resident of New Zealand". The question is whether Article 23(3) therefore precludes a New Zealand resident from obtaining any tax credit in respect of tax spared to a CFC.

The Court concluded that Article 23(3) must be read in light of Article 23(2)(a). That under the CFC rules, the income of the CFC is deemed to have been earned by the owner, and so the tax paid by the CFC is deemed to have been paid by the owner (the New Zealand resident). When this analysis is extended to Article 23(3), the only logical conclusion is that tax paid or payable by a New Zealand resident includes tax which is deemed to have been paid or to be payable by the New Zealand resident for the purpose of Article 23(2)(a).

The Court concluded that a New Zealand resident is entitled to a credit for tax spared in China to the CFC. This enables Article 23 to be read in a principled way, giving effect to its purpose of relieving double taxation.

The effect of Article 23 on New Zealand's domestic income tax legislation

The China DTA has direct effect in New Zealand and therefore pursuant to the China DTA, Ms Lin is entitled to credits for tax paid by and tax spared to the CFCs. New Zealand's domestic legislation must be interpreted consistently with and give effect to New Zealand's obligations under the China DTA.

Shortfall penalty

Given the decision, the question of shortfall penalties does not arise.

Result

The Court gave judgment for Ms Lin.

A question of standing

Case	Rhys Michael Cullen v The Commissioner of Inland Revenue [2017] NZHC 578
Decision date	28 March 2017
Act(s)	Section 26 Incorporated Societies Act 1908, ss 248, 260, sch 6 Companies Act 193, ss 89AB, 89D, 109, 113, 138B Tax Administration Act 1994, ss 51, 57 Goods and Services Tax Act 1985, r 15.1 High Court Rules 2016
Keywords	Strike out, standing, liquidation, incorporated and unincorporated societies

Summary

Mr Cullen brought a proceeding in relation to a goods and services tax return on behalf of Tamaki Rugby League Incorporated against the Commissioner of Inland Revenue ("the Commissioner"). The Commissioner applied to strike out this proceeding on the basis that, as Tamaki Rugby League Incorporated was struck off the register of incorporated societies at the time of the return and in liquidation at the time the proceedings were brought, Mr Cullen did not have standing. The High Court declined the Commissioner's strike out application, considering it tenable that the proceeding related to the unincorporated version of Tamaki Rugby League Incorporated, and that Mr Cullen could therefore have standing.

This judgment is under appeal.

Impact

There are concerns over the wider impact of this decision. Her Honour seems to suggest that the Commissioner is obligated to enter the disputes process and treat tax returns and dispute documents as valid even when they have not been filed on behalf of, or with the authority of, the taxpayer stated on the documents. This decision appears to broaden the ambit of *Commissioner of Inland Revenue v Alam* [2009] NZCA 273.

Facts

On 24 July 2006, the Tamaki Rugby League ("the Club") was registered on the Register of Incorporated Societies ("the Register") as an incorporated society ("the Society"). On 20 August 2010, the Society was placed into liquidation and the Society was removed from the Register on 19 November 2012.

The Society was restored to the Register as of 17 June 2016 following an application by Mr Rhys Cullen as he believed the Society was due a tax refund from Inland Revenue. The Society came back into existence as an incorporated society from that date forward. The Judge hearing the application to restore the Society to the Register refused to make "relate back" orders.

In the interim, it seems that Mr Cullen, as Chairman of the Club, had been taking steps to prepare and file various tax returns, including a goods and services tax ("GST") return for the period ended 31 May 2016 ("the Return"). The Return was in the name of the Society. The GST registration number used on the Return was the Society's. The Return sought a GST refund of approximately $14,000.

On 3 August 2016, the Commissioner issued a notice of assessment ("the Assessment"). The Assessment was also in the name of the Society and used the Society's GST registration number. The Assessment recorded that, rather than a refund of approximately $14,000, a refund of only approximately $100 was due. Mr Cullen says that there was a data entry error when Inland Revenue Department staff processed the Return.

On 26 August 2016, Mr Cullen issued a Notice of Proposed Adjustment ("the NOPA") in relation to the Assessment. Again, the NOPA was in the name of the Society, and it used the Society's GST registration number. In the NOPA, Mr Cullen challenged the validity of the Assessment.

Pursuant to ss 89G and 89AB(2) of the Tax Administration Act 1994 ("the TAA"), the Commissioner's Notice of Response ("the NOR") was due on 26 October 2016. On 5 September 2016, Mr Cullen commenced these proceedings, seeking a declaration that the Return is valid and a declaration that the Assessment is invalid.

On 7 September 2016, the Commissioner wrote to Mr Cullen acknowledging receipt of the NOPA and noting that the Commissioner intended to issue a NOR. On 14 October 2016, the Commissioner wrote again to Mr Cullen, stating that the Commissioner had confirmed that the Society was in liquidation and that the Commissioner would be directing further communications to the Official Assignee. No NOR was issued by the Commissioner prior to 26 October 2016.

On 19 September 2016, the Commissioner filed her application to strike out these proceedings.

Decision

Her Honour found that it was tenable that the Return, the NOPA and these proceedings were issued and/or brought for and on behalf of the Club as an unincorporated body, rather than the Society. There was no doubt that the Return was issued in the name of the Society and used the Society's GST registration number. However, her Honour's view was that did not mean that the taxpayer to whom the Return actually related could not be the Club. Her Honour considered it tenable that the Return could not in fact relate to the Society, because the Society did not exist during the period to which the Return relates.

Her Honour reached a similar conclusion in relation to the Assessment, finding that it was arguable that the Assessment was an assessment of the tax activities of the Club and not the Society.

Her Honour also found that if the Commissioner considered that a NOPA does not meet the requirements of s 89D, or is otherwise invalid and has not triggered the statutory disputes process, the appropriate course was to issue a NOR to that effect, so that that issue can be resolved through the disputes process and challenge proceedings. This enables the question of validity to be determined through the correct procedural route.

Accordingly, for these reasons her Honour considered it was arguable that Mr Cullen did not need the Official Assignee's consent to commence these proceedings and, as Chairman of the Club, had the necessary standing to bring them.

It was also found tenable that the Assessment was not deemed to be correct under s 109 of the TAA. This was because the premise underlying s 109, namely that the taxpayer could challenge the Assessment in challenge proceedings, did not exist.

Her Honour found that while it was an abuse of process for Mr Cullen to have commenced these proceedings prior to the disputes process running its course, as the Commissioner did not continue to engage in the disputes process she did not propose to exercise her discretion to strike out the proceedings as an abuse of process.

When crediting is not payment

Case	Commissioner of Inland Revenue v Leslie William Fugle [2017] NZCA 230
Decision date	1 June 2017
Act(s)	Subpart EH Income Tax Act 1994, ss 3 and 138G Tax Administration Act 1994, Determination G 12, District Court Rules 2014 r 9.6 and r 8.31, Court of Appeal (Civil) Rules 2005 r 53E(2)
Keywords	Accrual rules, financial arrangement rules, maturity, base price adjustment, spreading methods, payment, crediting shareholders current account, principal, interest, hearing authority, increased costs

Summary

The Court of Appeal held that crediting an amount to a shareholder's current account in respect of an existing liability in circumstances where there were insufficient funds for the shareholder to draw down the full amount, did not constitute the last payment contingent on the financial arrangement. Thus the arrangement had not matured under the financial arrangement rules ("FAR") and a base price adjustment ("BPA") was not triggered.

Impact

This decision clarifies that crediting to a shareholder's current account, when funds are not unreservedly at the disposal of the account holder will not constitute a final payment under the FAR so as to trigger a BPA.

Note: This decision applies the old FAR which have been changed.

Facts

A 1992 Settlement Deed provided that in consideration of Mr Fugle's payment of $90,000, the Bank of New Zealand ("Bank") assigned Mr Fugle a debt of $2,659,442.06 (plus accruing interest) owed to the Bank by Mr Fugle's company, Bathos Properties Ltd ("Bathos"). This transaction is a financial arrangement to which the financial arrangements rule, in subpart EH of the Income Tax Act 1994 applied.

During the 2005 tax year, Bathos credited $2,659,442 to Mr Fugle's current account.

Mr Fugle drew down $452,754 in the 2005 tax year; $1,064,364 in the 2006 tax year; and $751,475 in the 2007 tax year. The funds drawn down were used in part to support Mr Fugle and his family. Between 2001 and 2010, Mr Fugle returned no income and paid no income tax.

No financial statements were prepared for Bathos from the early 1990s to 2010, specifically, no financial statements were prepared since the date of the 1992 Settlement Deed.

The Commissioner of Inland Revenue ("the Commissioner") commenced an audit in July 2007 and financial statements for Bathos for the 2005, 2006 and 2007 years were prepared and provided to the Commissioner in 2010. In the financial statements the assignment of debt was credited, as a net sum in Mr Fugle's current account.

Following the audit, on 10 October 2014, the Commissioner issued a notice of assessment of an additional amount of income of $2,569,442 in the 2005 tax year, derived as the result of a required base price adjustment upon the maturity of the financial arrangement with the crediting to Mr Fugle's shareholder account.

Mr Fugle challenged the assessment on the grounds that there was no final payment and hence, no base price adjustment was required.

The Taxation Review Authority ("the Authority") accepted the Commissioner's argument that the Bathos indebtedness was paid by the crediting of the full amount of the debt to Mr Fugle's shareholder account. This was on the basis that the funds were placed at Mr Fugle's disposal and he was able to draw down against payment of that debt as and when he required. They held that it was not necessary for the full amount of the funds to have been immediately available to Mr Fugle. As the crediting of the entire amount of the debt was the last payment contingent upon the financial arrangement, the arrangement matured and a base price adjustment was required.

Mr Fugle appealed the Authority's decision to the High Court.

The High Court held that the crediting to Mr Fugle's current account in 2005 was not a payment; there was no sum of money to constitute a payment, but rather an assignment of debt. Consequently, there was no final payment under the FAR and a BPA was not yet triggered.

The High Court further held that the Authority erred in excluding evidence that had not been discovered to the Commissioner, and it accepted that that evidence proved the crediting to Mr Fugle's account occurred much earlier than the 2005 tax year.

The Commissioner appealed.

Decision

On the first issue, whether crediting in the 2005 tax year constituted payment for the purposes of the FAR, the Court of Appeal held that payment by crediting does not require the actual book entry in the current account to be made at the same time the act of payment is said to occur.

The Court of Appeal held that before there is payment, the company (here Bathos) would have had to have the full amount available to be drawn down by Mr Fugle in the normal course of business and in this matter, there was an implicit agreement between Bathos and Mr Fugle, that the assigned debt would be paid only as permitted by the available resources in the company from time to time. Payment in full was not made until the full amount was unconditionally available to be drawn down, and that did not occur in the 2005 tax year.

Consequently, the crediting of Mr Fugle's shareholder's account of an amount greater than the funds then available to Bathos was not the last payment contingent on the financial arrangement. Accordingly, the arrangement had not matured and a BPA was not triggered.

On the second issue, whether the Commissioner could raise an alternative argument that if no BPA was triggered, then Mr Fugle was required to return accrual income pursuant to one of the spreading methods under the FAR, the Court of Appeal held that because the Commissioner's Statement of Position did not raise an issue to the effect that there was an obligation on Mr Fugle to spread income over the term of the arrangement, s 138G(1) of the Tax Administration Act 1994 precluded the Commissioner from advancing this argument.

The Court of Appeal noted that while the Authority may, on application, allow an applicant to raise new propositions of law and new issues at a challenge to a disputable decision, the Court of Appeal is not granted the same power.

Despite refusing to consider the substance of the Commissioner's spreading method submission, the Court of Appeal at [41] of its judgment indicated that it did not endorse Cull J's view in the High Court that the spreading method had no application because the payments were "principal" and not interest citing *Sovereign Assurance Company Limited v Commissioner of Inland Revenue* [2013] NZCA 652, (2013) 26 NZTC 21-056 ("*Sovereign Assurance*").

In *Sovereign Assurance* the Court of Appeal recognised the central purpose of the accruals regime as being to eliminate the orthodox distinctions between capital and revenue such that the regime takes into account all cash flows.

On the final issue regarding the admissibility of new documents before the Authority, the Court of Appeal, by its conclusion on the primary issue, rendered this matter academic and unnecessary to address.

Mr Fugle sought increased costs on appeal, submitting that the spreading method argument was obviously precluded under s 138G and was clearly wrong and had resulted in increased complexity.

The Court of Appeal held that although it declined to consider the spreading method argument, it did not determine the argument lacks merit. The argument was raised in both the Authority and in the High Court, but was not ruled upon in either instances, thus the Commissioner was entitled to press the point.

No increased costs were awarded.

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