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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.

IN SUMMARY

Binding rulings

BR Prd 17/05 University of Melbourne 3

The Atlantic Fellows for Social Equity is a year-long post-graduate educational program led by the University of Melbourne that is open to New Zealand participants. This ruling applies to the financial support received by participants in the program. Participants will receive AU$75,000 over the course of the program, and may be reimbursed for various expenses. The University may also meet some expenses directly.

BR Prd 17/06 New Zealand Bloodstock Financing and Leasing Ltd 7

This ruling covers the leasing of bloodstock for use in breeding bloodstock progeny to customers by New Zealand Bloodstock Finance and Leasing Limited.

Questions we've been asked

QB 17/09: Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution? 10

This item is about whether there is a full or partial disposal of an asset where a person contributes an asset to a general or limited partnership as a capital contribution. The Commissioner's position is that there is a full disposal.

Commissioner's operational position on QB 17/09 - Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution? 18

The purpose of this item is to provide information on the transitional operational position for taxpayers who have applied a partial disposal approach prior to the issue of QB 17/09.

QB 17/10: Income tax and fringe benefit tax – insurance – group insurance policy taken out by employer for the benefit of an employee 19

This Question We've Been Asked (QWBA) considers the income tax treatment of group insurance policies taken out by an employer in respect of its employees, where the employer intends to hold the policy on behalf of its employees. The QWBA concludes that the premiums will be subject to FBT. The QWBA also concludes that any amounts paid out under the group insurance policy will not be income of the employer, but may be income of the employee in some circumstances.

Standard practice statements

SPS 17/03 Loss offset elections between group companies 23

This statement sets out certain practices that the Commissioner will accept for offsetting losses by election between group companies. It also sets out the consequences of specific events that can impact on a loss offset and how these should be addressed.

Legal decisions - case notes

Court confirms hardship provisions do not apply when Commissioner is pursuing bankruptcy 29

On 1 November 2017 (reasons provided on 13 November 2017) the Court of Appeal gave judgment for the Commissioner of Inland Revenue ("the Commissioner") and dismissed the appellants' appeal against Lang J's dismissal of their application for judicial review. The appellants had sought a review of a decision by the Commissioner declining their application for financial relief.

The appellants claimed apparent bias and that the Commissioner had failed to take into account the appellants' inability to make mortgage payments.

Taxation Review Authority confirms the Commissioner's ability to attribute income to a non-party in a transaction 30

The disputant taxpayer had benefited from international money transfers, foreign currency purchases and domestic transfers and card expenditure which the Commissioner of Inland Revenue ("the Commissioner") considered had been conducted on the disputant's behalf through trusts and companies wholly owned and operated by the disputant's friend. The Taxation Review Authority largely confirmed the Commissioner's assessments but found that certain isolated transactions had an insufficient link with the disputant and accordingly disallowed those amounts.

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Legal decisions - case notes (continued)

High Court lacks jurisdiction to review where there is no exercise of a statutory power of decision 33

The Applicant ("Dr Muir") brought proceedings in the High Court seeking to judicially review the Taxation Review Authority's refusal to accept for filing his "Second Amended Notice of Claim". This proceeding concerned the Commissioner of Inland Revenue's application to dismiss Dr Muir's judicial review application.

Judicial review proceeding alleging bias struck out 34

Mr Tamihere, a current bankrupt, filed a statement of claim and an affidavit in support seeking a judicial review of actions taken by Judge Andrée Wiltens during a civil list hearing in the Manukau District Court on 12 June 2017. The Commissioner of Inland Revenue applied to have the matter struck out on the basis that it disclosed no reasonably arguable cause of action, was frivolous, vexatious and an abuse of the Court's process.

Deductibility under s DB 55(1) 35

NRS Media Holdings Ltd ("NRS") sought to claim deductions under s DB 55 of the Income Tax Act 2007, for expenditure incurred by its head office in managing NRS' subsidiaries that periodically pay NRS dividends. The Commissioner of Inland Revenue ("the Commissioner") disallowed the deductions and NRS challenged the Commissioner's assessment.

The High Court found DB55 requires expenditure to be factually and causally incurred in the derivation of foreign dividend income. The expenditure claimed was insufficiently related to the derivation of foreign dividends which was one step removed from the purpose of the expenditure; which was to increase subsidiary value.

Attempt to relitigate matters previously determined struck out as an abuse of process 36

Mr Tamihere filed judicial review proceedings which appeared to seek to revisit a 2012 District Court decision granting the Commissioner of Inland Revenue ("the Commissioner") judgment against Mr Tamihere for unpaid tax debt as well as decisions resulting in criminal convictions and sentence. The Commissioner applied to strike out the proceeding.

BINDING RULINGS

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

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

Product Ruling – BR Prd 17/05

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 the University of Melbourne.

Taxation Laws

This Ruling applies in respect of Part C and s CW 36 of the Income Tax Act 2007 and s 2 and s 8(1) of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is the payment by the University of Melbourne (the University), on behalf of The Atlantic Fellows Program for Social Equity Trust (the Trust), of amounts to persons (each a Participant) enrolled in the Atlantic Fellows for Social Equity postgraduate education program (the Program) established and administered by the University. Details of the Arrangement are set out in the paragraphs below.

Background to the Program

1. The University has established the Program with the aim of developing up to 400 leaders with the skills and capability to lead social change for indigenous and marginalised communities in Australia, New Zealand, and the wider Asia–Pacific region. The Program will commence in 2017 and run for 20 years. Up to 20 Participants will undertake the Program each year.
2. Participants who successfully complete the Program will be awarded a postgraduate qualification from the University. That qualification will take the form of either a postgraduate certificate or, if the Proposal (as defined in paragraph 7) satisfies certain requirements (discussed below), a Master's of Social Change Degree (which will be accredited as a Master's Degree (Research) under the Australian Qualifications Framework).
3. Funding for the Program has been provided by a US$50 million grant from The Atlantic Philanthropies. In addition, the Australian Government will contribute funding of up to AU$40 million, and the Queensland University of Technology and the University of Auckland will each provide further financial support.
4. While the University has the ultimate responsibility for administering the Program, various partner organisations will assist the University to deliver the Program. Partner organisations may assist with Participant selection, development and delivery of the Program curriculum, and supporting Participants by providing faculty, facilities and resources.

Participant selection

5. The University will have primary responsibility for selecting Participants for the Program each year. Selection criteria (to determine whether a particular applicant should be a Participant) will focus on six main factors: relevant experience and skills, the Proposal, commitment to social change, diversity, employer support, and based in Australia or New Zealand.
6. *Relevant experience and skills*: The University will consider all academic, employment, voluntary and leadership experience an applicant may have that is relevant to the Program and any social change activities in which the applicant has been or is involved. It is expected that most applicants will be at a mid-point in their career and will already have some of the skills and experience necessary to be social change leaders.
7. *Proposal for social change*: Each applicant will be required to submit an outline of a social change proposal (Proposal) they wish to develop if they are accepted as a Participant. The outline will include the Proposal's purpose, intended outcomes and indicative budget. As part of the application process, the University will assess the general quality and innovation of each Proposal.

8. *Commitment to social change*: An applicant's commitment to social change will be an important consideration relevant to their selection as a Participant. To assess this commitment, an applicant will be required to provide a personal statement outlining why they wish to be selected for the Program. They will also be required to provide referee reports from at least three referees who can speak to the applicant's capacity to work with socially marginalised communities.
9. *Diversity*: The University aims to include Participants from a variety of backgrounds, sectors and disciplines. The University will focus on selecting Participants from socially disadvantaged groups and on having a mix of indigenous and non-indigenous Participants.
10. *Employer support*: If selected to participate in the Program, an applicant will be required to spend a significant amount of time attending the Program and developing their Proposal. Therefore, if an applicant intends to maintain an existing employment relationship throughout the Program, the applicant will be required to provide a letter from their employer to confirm that the employer will allow the applicant sufficient leave to enable the person to complete the Program.
11. *Based in Australia or New Zealand*: Until 2020, applicants will be selected only from Australia or New Zealand (except in certain exceptional circumstances). After 2020, the University will reconsider whether to accept applicants from other countries into the Program (for example, from Pacific Island countries).
12. The selection criteria will not be applied in a way that favours an applicant who happens to have or to establish an employment relationship with any of the parties to the Arrangement.

Program outline

13. Participants in the Program will be enrolled in a 12-month postgraduate education course, which will have two components: Modules and Development of the Proposal.

Modules

14. Participants will be required to complete a series of course modules designed to expose Participants to a variety of topics, contexts and locations relevant to leadership and social change.
15. The modules will be taught in a variety of settings in New Zealand and Australia. Settings will include the University's Melbourne campus and some of the campuses of the partner organisations. Participants will also complete fieldwork at various geographical settings across Australia and New Zealand. In some cases, Participants may also conduct fieldwork in other countries.
16. Participants will be expected to physically attend each module.
17. Modules will have different durations depending on the topics covered. The duration of the modules will range from a few days to several weeks. Attendance at the modules is a full-time commitment, so Participants will not have time to undertake any full-time work while attending the modules.
18. Participants will spend no less than 70 days attending the modules.

Development of the Proposal

19. A fundamental part of the Program is the expectation that each Participant will research and develop the Proposal they submitted when they applied to participate in the Program. While attending the Program, Participants will be expected to fully develop and refine their Proposal to the necessary standard to allow a Master's Degree to be conferred, with assistance from the University, partner organisations and certain other stakeholders and interested parties.
20. The University expects that the amount of time Participants will spend researching and developing their Proposals will vary between Proposals. The time will vary because no two Proposals will be the same and the tasks involved in completing each Proposal could be quite different. Under the Australian Qualifications Framework, a Master's Degree (Research) qualification must be designed so that at least two-thirds of the Program is dedicated to undertaking research. The development of the Proposal will satisfy this research requirement.
21. At the end of the Program each Participant will be invited to present a final written Proposal at an event that will feature representatives from government, business, community, academic, and philanthropic sectors. Following that presentation, the University may publish the final Proposal.
22. A specific faculty member at the University or from a partner organisation will be appointed to mentor each Participant in relation to Program requirements, including the development of Proposals. There will be no formal requirements regarding contact time, given that the circumstances of each Participant and their Proposal will be different. However, the University expects Participants to be in regular contact with mentors.

23. Each Participant will also have a personal coach who will work with the Participant on an individual basis to support their professional and personal development. Coaches will be selected to match each Participant and will be independent of the University.

Qualifications

24. All Participants who successfully complete the Program will obtain a postgraduate qualification from the University.
25. The University expects each Participant to approach the Program on the basis that they are working towards a Master's level qualification and that the amount of work that each Participant should put into the Program will reflect the intended standard of the qualification.
26. Provided that a Participant submits a final Proposal for assessment at the end of the Program, the University expects that Participants will obtain a Master's of Social Change Degree. Where a Participant submits a Proposal that does not meet the necessary standards to allow a Master's Degree to be conferred, the Participant will instead be awarded a postgraduate graduate certificate.

Contributions to Participants

27. The University has established the Trust, from which a payment of AU$75,000 (the Contribution) will be made to each Participant. The Contribution will be paid in instalments during the Program and Participants will receive instalments on the same dates and in the same amounts. Instalment payments will be spread over the term of the Program, with instalments being paid both during the module section of the Program and after this while the Participant is working on his or her Proposal.
28. The payment of each instalment to a Participant will be dependent on the Participant's progress in the Program. If a Participant withdraws from the Program or the University determines that a particular Participant is no longer actively participating in the Program, they will forfeit any right to instalments that they have not already received.
29. The purpose of the Contribution is to minimise a Participant's financial barriers to undertaking the Program. The Contribution is intended to help Participants cover their on-going living costs and costs associated with completing the Program and developing their Proposal (for example, research materials).
30. Because of the time commitment involved and the level of the qualification sought, the University expects that many Participants will be unable to undertake full-time employment while they are participating in the Program. In all cases, full-time employment will not be possible when Participants are attending the modules.
31. The funding for the Contribution will come from the Trust, which will transfer the necessary funding to a bank account controlled by the University, to be disbursed to the Participants.
32. As the Contribution will be paid in instalments as a Participant progresses through the Program, it is unlikely a Participant will be required to repay any of the instalments previously received, even if the Participant does not successfully complete the Program, except in very exceptional circumstances (e.g. in instances of fraud). However, withdrawal from the Program will mean that a Participant will cease to be entitled to any further instalments that they would have otherwise been entitled to receive if they had successfully continued in the Program.

Expenses

33. In addition to providing the Contribution, the University will also agree to meet certain additional costs that might otherwise be a barrier to a Participant's participation in the Program. These costs may include:
    - costs associated with travelling to attend modules;
    - the cost of a Participant's accommodation during the modules; and
    - costs associated with a Participant's special needs that may affect their ability to participate in the Program (for example, if a Participant has a disability, the University will cover the cost of additional resources that that Participant requires, such as a reader/writer or signer (for the hearing impaired). This is to ensure that the Participant's disability does not impede their successful completion of the Program).

    (the Expenses)
34. It is anticipated that, like the Contribution, amounts used to make payments for the Expenses will generally come from the Trust (with the University making disbursements of the Expenses funding as agent for the Trust). However, it is also possible that in some circumstances the University may fund the Expenses directly itself as a part of the Program (i.e. as opposed to the Expenses funding being sourced from the Trust).

35. The University will generally pay for any Expenses by making payments to the third party suppliers of the goods and services. It is possible that in rare circumstances a Participant may pay Expenses associated with the Program personally. In those circumstances, the University will generally reimburse the Participant for the cost of the Expenses that they have incurred.

Intellectual property

36. Each Participant retains ownership of any intellectual property developed by the Participant during the course of participating in the Program (the Fellowship Intellectual Property).
37. Each Participant grants to the University a perpetual, non-exclusive, worldwide licence to use, reproduce, communicate and adapt the Fellowship Intellectual Property for non-commercial research, teaching and other academic purposes, as well as any purposes associated with the promotion of the Program (Licence). The Licence granted to the University includes a right of sub-license to The Atlantic Philanthropies and to the General Atlantic Corporation, each of whom may assign their sub-licence as they see fit.
38. The Licence is irrevocable and royalty-free.

Atlantic Fellows for Social Equity Fellow Agreement

39. The contractual arrangements between the University and a Participant will be recorded in an Atlantic Fellows for Social Equity Fellow Agreement.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Contribution is exempt income of a Participant under s CW 36 of the Income Tax Act 2007.

b) The Contribution paid to a Participant is:

   i) not consideration, as that term is defined in s 2 of the Goods and Services Tax Act 1985, for the supply of goods or services by the Participant; and

   ii) not subject to goods and services tax under s 8(1) of the Goods and Services Act 1985.

c) Expenses that are paid directly by the University to third parties are not income of a Participant under any provision in Part C of the Income Tax Act 2007.

d) Amounts paid by the University to a Participant to reimburse him or her for Expenses that the Participant has directly incurred as part of the Program are not income of the Participant under any provision in Part C of the Income Tax Act 2007.

e) Expenses that are paid directly by the University to third parties in relation to a Participant:

   i) are not consideration, as that term is defined in s 2 of the Goods and Services Tax Act 1985, for the supply of goods or services by the Participant; and

   ii) the Participant has no obligations under the Goods and Services Tax Act 1985 in relation to such Expenses.

f) Amounts paid by the University to a Participant to reimburse him or her for Expenses that the Participant has directly incurred as part of the Program:

   i) are not consideration, as that term is defined in s 2 of the Goods and Services Tax Act 1985, for the supply of goods or services by the Participant; and

   ii) the Participant has no obligations under the Goods and Services Tax Act 1985 in relation to such Expenses.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 16 October 2017 and ending on 16 October 2020.

This Ruling is signed by me on the 16th day of October 2017.

James Mulcahy
Investigations Manager, Investigation and Advice

Product Ruling – BR Prd 17/06

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 New Zealand Bloodstock Finance and Leasing Limited.

Taxation Laws

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

This Ruling applies in respect of ss BG 1, DA 1, EA 3, EC 39 to 48, EJ 10, FA 6 to FA 11B, FA 12 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of a thoroughbred breed of horse (bloodstock) on the terms provided in the Bloodstock Lease (Lease) to Purchase Agreement (Bloodstock Agreement) entered into by New Zealand Bloodstock Financing and Leasing Limited (NZBFLL) and its customers, for use in the customers' "business" (as defined in s YA 1) of breeding and selling the leased bloodstock's progeny.

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

Background

1. NZBFLL is a wholly owned subsidiary of New Zealand Bloodstock Holdings Limited (NZB Holdings).
2. NZBFLL was, prior to 2 July 2014, known as New Zealand Bloodstock Leasing Limited (NZBLL). NZBLL had on 1 July 2014 amalgamated with New Zealand Bloodstock Finance Limited (NZBLL becoming the amalgamated company). New Zealand Bloodstock Leasing Ltd then changed its name to NZBFLL on 2 July 2014.

Purpose of the Arrangement

3. NZB Holdings established NZBFLL to expand its business and increase sales of bloodstock in New Zealand by making investment in the bloodstock industry more attractive to existing and new entrants. The availability of leasing reduces the initial level of cash required by existing and new entrants to the bloodstock business to acquire bloodstock. The leasing arrangement gives the customers the opportunity to participate in the business of breeding bloodstock by leasing the bloodstock. New Zealand Bloodstock Limited ("NZB") is contractually entitled to provide auctioning services for any progeny of the bloodstock. The benefit for the NZB Group from the leasing arrangement is that NZB gets the commissions from selling the bloodstock and the commissions from any sale of progeny from the bloodstock, in addition to NZBFLL's right to receive the lease payments.
4. The customer is in the business of leasing bloodstock to breed and sell its progeny. This business does not involve the sale and disposal of leases.

Sourcing of the Bloodstock

5. NZBFLL acquires bloodstock from third party owners, and then leases this bloodstock to the customer. Alternatively, the customer purchases the bloodstock from the third party owner, sells it to NZBFLL, and then leases the bloodstock from NZBFLL. This helps protect NZBFLL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases the transaction as a whole (e.g., sale and lease-back) is contemplated by the parties at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.
6. NZBFLL may also acquire bloodstock that is already owned by the customer, either through an earlier purchase or because it is homebred (the "already owned bloodstock"). The proceeds or sale of the already owned bloodstock are used for further investment in the customer's bloodstock breeding business.
7. It is agreed in the Bloodstock Agreement that the customer may purchase the bloodstock at the end of the lease. The Bloodstock Agreement describes the Arrangement:

   "BACKGROUND

   A. At the request of the Lessee and the Guarantor (if any), the Owner has purchased the Bloodstock in order to lease the Bloodstock to the Lessee and the lessee has agreed to take on lease the Bloodstock with the right to purchase the Bloodstock at the expiration of the lease and otherwise upon the terms and conditions in this Lease.

BINDING RULINGS

B. The Lessee has entered into this Lease for the purpose of obtaining breeding stock to use in the Lessee's business of breeding bloodstock for sale…"

Lease Particulars

8. The terms and duration of leases are based on individual requirements, credit risk, and potential breeding expectations. Lease periods may vary but a typical lease term is three years for fillies or mares and two years for colts or stallions.
9. The customer will make payments (Lease Payments) for the lease of the bloodstock, in the amount(s) set out in the Lease.

Residual Value

10. The bloodstock has a defined Residual Value under the Bloodstock Agreement. The Residual Value is an estimate (at the time of signing the lease) of the value the bloodstock will have at the end of the lease. "Residual Value" is defined in the Bloodstock Agreement as:

    "Residual Value" means the amount specified in the Schedule being a pre-estimate of the value of the Bloodstock upon the expiry of this Lease.

11. Under clause 8(b) of the Lease, the Residual Value is exclusive of GST:

    (b) ***Liability for residual Value:*** You are liable to pay the Residual Value exclusive of GST and to pay all other monies owing to Us notwithstanding any changes in circumstances or changes to the Bloodstock or its condition during the term of this Lease.

Lease Termination Date

12. The lease termination date ("Expiry Date") is the date on which the lease ends. The customer may purchase the bloodstock on the Expiry Date for the Residual Value. If the customer does exercise their option to purchase the bloodstock NZBFLL will transfer title to the customer in return for payment of the Residual Value.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The leased bloodstock is mature for use in breeding and is capable of being used for breeding at all times during the period to which each Lease Payment relates.

b) Any racing undertaken by the leased bloodstock is only incidental to the actual use of the bloodstock for breeding during the lease term.

c) The Lease Payments are genuine, arm's-length amounts for the possession and use of the bloodstock.

d) The Residual Value of the bloodstock is a reasonable, and the parties' best, estimate of the likely market value of the bloodstock at the Lease Termination Date.

e) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.

f) No consideration is paid for the option to purchase the bloodstock at the Lease Termination Date.

How the Taxation Laws apply to the Arrangement

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

a) The bloodstock lease payments are deductible under s DA 1(1) and none of the general limitations in s DA 2 apply, provided that:
   - No provision in subparts DB to DZ applies to prevent a deduction in s DA 1(1); and
   - The customer is a "New Zealand resident" (as defined in s YA 1).

b) At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, s EA 3 applies to require the unexpired portion of any lease payments paid in advance to be included in the customer's income in the current income year and to be an amount for which the customer is allowed a deduction in the following income year.

c) The valuation and specified write-down provisions in s EC 39 to EC 48 apply to the customer when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date.

d) The "cost price" of the bloodstock for the purposes of s EC 39 to EC 48 is the Residual Value stated in the Bloodstock Lease to Purchase Agreement.

e) The financial arrangements rules in subpart EW do not apply to the Arrangement.
f) Section EJ 10 does not apply to the Arrangement.
g) Sections FA 6 to FA 11B do not apply to the Arrangement.
h) Section FA 12 does not apply to the Arrangement.
i) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 December 2017 and ending on 7 December 2022.

This Ruling is signed by me on the 23rd day of November 2017.

Howard Davis
Director (Taxpayer Rulings)

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 17/09: Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?

This QWBA is about whether there is a full or partial disposal of an asset where a person contributes an asset to a general or limited partnership as a capital contribution. Where the asset disposed of is, for example, depreciable property or revenue account property the disposal may result in income or loss for the person who disposed of the asset. Whether there is a full or partial disposal is relevant to the amount of income or loss the person may have from contributing the asset to the partnership.

Question

1. Where a person owns an asset and contributes that asset to a partnership as a capital contribution, does the person dispose of:
   - the entire asset (**full disposal**); or
   - only part of the asset, because the person, in their capacity as a partner of the partnership, has an interest in the asset, under s HG 2 of the Income Tax Act 2007 (the Act), proportionate to the person's partnership share (**partial disposal**)?

Answer

2. There is a full disposal of the asset.
3. In summary, this is because:
   - Neither s HG 2 nor any other provision in the Act specifies or determines whether there is a full or partial disposal where a person contributes an asset to a partnership as a capital contribution. In the absence of any applicable provision in the Act, the answer is determined under partnership law and the general law.
   - Where a person contributes an asset to a general partnership, the legal ownership of the asset and the person's interest in the asset fundamentally change. Before disposal, the person is the sole owner of the asset. Following disposal, the asset ceases to be the person's property. The asset belongs to the partners of the partnership as joint owners and is partnership property. The person and their co-partners each have a beneficial interest in the whole of the asset, and the asset, as partnership property, must be used exclusively for the purposes of the partnership. There has been a disposal of the asset by its sole owner to joint owners.
   - Where a person contributes an asset to a limited partnership, the person has fully disposed of the asset to a separate legal person who has not held any previous interest in the asset.
4. This means, for example, that where the asset disposed of is either depreciable property or revenue account property (which includes trading stock) for the person, the person may have an amount of depreciation recovery income or depreciation loss, or income or loss, calculated on the basis that the person has fully disposed of the asset.

Explanation

5. Uncertainty exists about whether there is a full or partial disposal where a person contributes an asset, which is owned by the person, to a partnership as a capital contribution. The Commissioner has been asked to clarify her position on this question.
6. This item focuses on the income tax consequences for the person disposing of the asset to a partnership as a capital contribution.

Meaning of "partnership"

7. For the purposes of the Act, the term "partnership" is defined in s YA 1 to mean:
   - the relationship that subsists between a group of 2 or more persons who carry on a business in common with a view to profit (a general partnership);

- a limited partnership registered under the Limited Partnerships Act 2008 (limited partnership);
- a joint venture, if the venturers all choose to be treated as a partnership for the purposes of the Act and the Tax Administration Act 1994;
- co-owners of property if the co-owners all choose to be treated as a partnership for the purposes of the Act and the Tax Administration Act 1994, provided the co-owners are not co-owners only because they are shareholders of the same company, or settlors, trustees, or beneficiaries of the same trust.

8. A listed limited partnership, which is an entity or group of persons that is listed on a recognised exchange, is a company, and not a partnership, for the purposes of the Act: s YA 1 definitions of "company" and "listed limited partnership".
9. This item considers whether there has been a full or partial disposal where a person contributes an asset to a general partnership or limited partnership as a capital contribution. It is outside the scope of this item to consider the full or partial disposal question in relation to either joint venturers or the co-owners of property.

Taxation of partnerships under the Act

10. Sections HG 2 to HG 12 of the Act contain rules concerning the taxation of partnerships.
11. Section HG 2(1) provides that a partnership is transparent and is "looked through" in accordance with a partner's partnership share – that is, for a particular right, obligation, or other property, status or thing, the share that a partner has in the partnership: s YA 1 definition of "partnership share".
12. More specifically, s HG 2(1) provides that for the purposes of a partner's liabilities and obligations under the Act, in their capacity as partner of a partnership, the partner is treated, unless the context requires otherwise, as:
    - carrying on an activity carried on by the partnership and having a status, intention and purpose of the partnership, and the partnership is treated as not carrying on the activity or having the status, intention, or purpose (s HG 2(1)(a)); and
    - holding property that a partnership holds, as being party to an arrangement to which the partnership is a party, and as doing a thing and being entitled to a thing that the partnership does or is entitled to in proportion to the partner's partnership share, and the partnership is treated as not holding the property, being a party to the arrangement, and not doing the thing or being entitled to the thing (s HG 2(1)(b)–(d)).
13. It has been suggested that s HG 2(1) has the effect that where a person, in their non-partner capacity, disposes of an asset to a partnership as a capital contribution, the person disposes of only part of the asset because following the disposal, the person, in their capacity as partner, is treated as holding the asset in proportion to their partnership share.
14. The Commissioner's view is that s HG 2(1) is not directly relevant to whether there is a full or partial disposal because:
    - The rules in s HG 2(1) apply for the purposes of determining a partner's liabilities and obligations under the Act in their capacity as partner of a partnership.
    - The income tax consequences for a person disposing of an asset to a partnership as a capital contribution arise in the person's non-partner capacity (as transferor of the asset) and do not arise in the person's capacity as a partner of the partnership.
    - Any income tax consequences on the disposal cannot give rise to partnership income or loss because the partnership is acquiring, and not disposing of, the asset.
15. The Commissioner is aware that it has been suggested that the full disposal approach ignores the wording of s HG 2(1) and that the section can be interpreted as a broader statement of transparency that applies to a person in their non-partner capacity. The Commissioner considers:
    - These views disregard the literal wording of s HG 2(1), which explicitly states that the rules in s HG 2(1) apply to a partner "in their capacity of partner of a partnership". These words are unambiguous and explicitly provide that a person who is a partner of a partnership may have liabilities and obligations under the Act in both their partner and non-partner capacities.
    - The literal wording of s HG 2(1) does not state that there is no disposal of that part of the asset that is treated as being held by the partner that contributed the asset. And nor does it state that the part of the asset that is treated as being held by the partner is to be disregarded in determining the partner's liabilities and obligations, in their non-partner capacity, in relation to their disposal of the asset.
16. The Commissioner also notes s HG 2(1)(b) provides that the "partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share". The Commissioner considers that this look-through proportional holding of property rule applies only to "partnership property", which requires at law (and logically) a transfer of all of the beneficial

and/or legal interests in the property to the partnership. Under the partial disposal approach, however, it is said that only part of the asset is disposed of by the person contributing the asset to the partnership. In the Commissioner's view:

- It is not possible for 100% of an asset to be partnership property and subject to s HG 2(1)(b) if only part of the asset has been disposed of to the partnership.
- The underlying logic of the partial disposal approach appears to be as follows:
  - there is a full disposal of the asset so that s HG 2(1)(b) applies to the entire asset, with the consequence that the partners are treated as holding the asset in proportion to their partnership shares; and
  - the view that s HG 2(1)(b) then has the effect of recharacterising the full disposal as a partial disposal (in that there is no disposal to the extent of the contributor's partnership share in the asset).
- Section HG 2(1)(b), on its plain and ordinary meaning, does not have the effect of recharacterising a full disposal as a partial disposal.

17. The Commissioner considers that ss HG 3 to HG 12 are also not relevant to the question considered in this item. This is because ss HG 3 to HG 10 concern the disposal of a partner's interest in a partnership and the disposal of property that a partner is treated as holding and ss HG 11 and HG 12 contain rules that limit deductions by partners of limited partnerships.
18. Further, no provision in any other part of the Act specifically deals with whether there is a full or partial disposal where a person contributes an asset to a partnership as a capital contribution. Although the word "dispose" is defined in s YA 1 of the Act for the purposes of specific sections, none of these sections are relevant to the full or partial disposal question. In the absence of any applicable provision or definition in the Act, it is the Commissioner's view that the answer must be determined under partnership law and general law.

General partnerships

19. The Partnership Act 1908 applies to general partnerships.
20. A general partnership is an unincorporated body of persons. It has no separate legal personality of its own: *R v Holden* [1912] 1 KB 483; *Meyer & Co v Faber (No 2)* [1923] 2 Ch 421; and *Laws of New Zealand* Partnership and Joint Ventures (online ed) at [6]. Persons who have entered into partnership with one another are called collectively a "firm": s 7 of the Partnership Act 1908. Every partner of a firm is liable jointly with the other partners of the firm for all debts and obligations of the partnership incurred while a partner: s 12 of the Partnership Act 1908.
21. Section 23 of the Partnership Act 1908 provides that "partnership property" includes all property and rights and interests in property originally brought into the partnership stock or acquired on account of the partnership or for the purposes and in the course of the partnership business. This section provides further that partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.
22. Under partnership law, the following principles apply to partnership property:
    - A partner does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership: *Hadlee v CIR* [1991] 3 NZLR 517 (CA) at 528; *Hadlee v CIR* [1993] 2 NZLR 385 (PC) at 388; and Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-08.
    - Subject to any express or implied agreement by the partners, all the partners of a general partnership have identical and equal interests in the partnership property: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-04.
    - Legal title to partnership property may be held by one of the partners, some of the partners, or all of the partners. If the legal title to partnership property is vested in only some of the partners, they hold the relevant property as trustees for all of the partners: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-07.
    - During the continuance of a partnership, the beneficial interest of a partner is in the nature of a future interest taking effect in possession on (and not before) the determination of the partnership (whether by a change in the membership or by general dissolution). This is because each partner is entitled to require the partnership property to be applied for the purposes of the partnership and no partner is entitled to use or enjoy their share of those assets to the exclusion of their co-partners: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-08.

Limited partnerships

23. A limited partnership is a limited partnership registered under the Limited Partnerships Act 2008: s 6 of the Limited Partnerships Act 2008.
24. A limited partnership is a separate legal person: s 11 of the Limited Partnerships Act 2008.
25. A limited partnership must have at least one general partner and at least one limited partner, and a person may not be both a general partner and a limited partner of the same partnership: s 8 of the Limited Partnerships Act 2008.
26. Each general partner is jointly and severally liable with both the limited partnership and the other general partners for the unpaid debts and liabilities of the limited partnership: s 28 of the Limited Partnerships Act 2008. However, unless the partnership agreement provides otherwise, a general partner is liable for any debts or liabilities of the limited partnership only to the extent that the limited partnership cannot pay those debts or liabilities: s 28 of the Limited Partnerships Act 2008.
27. A limited partner who does not take part in the management of the limited partnership is not liable for the debts and liabilities of the limited partnership: s 31 of the Limited Partnerships Act 2008.

Nature of the capital of a partnership and of a capital contribution

28. The capital of a partnership has the following three attributes:
    - The capital of a partnership is the aggregate of the sums contributed by its members for the purpose of commencing and carrying on the partnership business and intended to be risked by the members in that business.
    - The capital of a partnership is not the same as its property: the capital is a sum fixed by the agreement of the partners, while the actual assets of the partnership vary from day to day and include everything belonging to the partnership and having any monetary value.
    - Once a person has introduced an asset into a partnership as a capital contribution with an agreed 'capital' value in the partnership's books, the asset ceases to be the person's property and thereafter belongs to the partnership and is partnership property. The person ceases to have any beneficial interest in the asset which is qualitatively different to that of his, her, or its, co-partners.

    (See *CIR v Dormer* (1997) 18 NZTC 13,446 (HC) at 13,453; *Bieber v Teathers Ltd (in liquidation)* [2012] 2 BCLC 585 (Ch) at [76]; and Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 17-01, 17-02 and 18-37).
29. When an asset is contributed to a partnership as a capital contribution, its legal ownership and juristic character changes. Where the asset is contributed to a general partnership, the asset becomes property of the partnership and the partners become the joint legal owners of the whole asset.
30. This was explained by the English High Court in *Bieber v Teathers Ltd* in the context of contributions to general partnerships. Teathers was the promoter and managing partner of the Take 3 TV partnerships, which were commercially unsuccessful. Teathers had invited subscriptions from investors in an information memorandum and used the subscriptions to establish the partnerships. Investors claimed there had been a breach of trust by Teathers because it had not applied the subscriptions in accordance with criteria in the memorandum. The Court held there was a trust obligation, but the obligation had ended when the subscriptions were paid from a settlement account to the relevant partnership account. This was because the partnership deeds stated that the subscriptions were capital of the partnerships and on payment to the relevant partnership account the subscriptions became capital of the partnership. The Court said at [76]:

    > Of course, real money moved. It moved from the HSBC settlement account to the relevant Barclays partnership account. When that happened the legal ownership and juristic character of the money changed. It ceased to belong to Teathers and became the property of the partners. As is stated in *Lindley & Banks on Partnership* (19th edn) at 17–02:
    >
    > > "… once a partner has brought in the asset and been credited with its agreed "capital" value in the firm's books, the asset as such will cease to be his property and will thereafter belong to the firm …"
    >
    > **It belonged to the firm not in the sense that each partner individually owned that little bit of the Barclays partnership account which represented his payment, but in the sense that they were joint owners of the whole** (just as they were jointly and severally liable on the account). By "joint owners" I do not mean that they were beneficial joint tenants or tenants in common. **I mean that the partners together were joint legal owners and that each partner was entitled in equity to that floating and unascertainable share of the partnership property that would be determined only at dissolution.** The money ceased to be money held by Teathers under an irrevocable offer … [and] became a partnership asset to be dealt with under the terms of the partnership deed and s 20 of the Partnership Act 1890 [a provision materially the same as s 23 of the Partnership Act 1908 (New Zealand)]. [Emphasis added]

31. In dismissing an appeal by Teathers, the English Court of Appeal agreed with the High Court that once the subscriptions had been paid into the relevant partnership account, the subscriptions belonged to the partnership and vested in the general partners as joint legal owners. Consequently, each investor's beneficial ownership of his or her individual subscription ceased and was replaced with a right to participate in the profits of the partnership and in its net assets on dissolution: *Bieber v Teathers Ltd (in liquidation)* [2013] 1 BCLC 248 (CA) at [59].

Capital contributions to limited partnerships

32. The term "capital contribution" is defined in s 37 of the Limited Partnerships Act 2008. The definition provides that the capital contribution of a partner is the share of the assets contributed, or agreed to be contributed, by a partner to the limited partnership or assigned to a partner by another partner and may take any form and may be made on terms (if any) provided in the partnership agreement.

33. Section 38 of the Limited Partnerships Act 2008 provides that the partnership interest of a partner is the partner's share of the assets of the limited partnership, the partner's right to receive distributions from the limited partnership, and the partner's right to any other benefit conferred by the partnership agreement and includes any liability or other burden of the partner in relation to the limited partnership. Since a limited partnership is a separate legal person, a partner's share of the assets of a limited partnership is only a notional share because the assets are owned by the limited partnership: *Laws of New Zealand* Limited Partnerships (online ed) at [17].

34. It is the Commissioner's view that the answer to the question as to whether there is a full or partial disposal where a person contributes an asset to a limited partnership as a capital contribution is that there is a full disposal of the asset. This is because the person contributing the asset and the limited partnership are each a separate legal person. Further, there is no continuity of interest because the limited partnership has not owned any previous interest in the asset.

35. The Commissioner considers that the decision of the Court of Appeal for British Columbia in *Edenvale Restoration Specialists Ltd v British Columbia* 2013 BCCA 85 supports her view. The issue in *Edenvale* concerned the amount of tax payable under the Social Service Tax Act, RSBC, 1996, on the purchase of property by a limited partnership, which had paid the purchase price, in part, by issuing the vendor with units in the limited partnership representing 15% of the total units in the partnership. Under the Ontario Limited Partnership Act 1990 a limited partnership is not a separate legal person and the plaintiff contended, on the basis of *Seven Mile Dam Contractors v British Columbia* (1979) 104 DLR (3d) 274 (SC), which is discussed later in this item, that tax was payable on 85%, not 100%, of the transferred property. The Court rejected that contention and distinguished *Seven Mile*. The Court held that under the partnership agreement, and on the facts, that it was the general partner, a limited liability entity, that was the purchaser of the property. Consequently, the general partner, as purchaser, was required to pay tax on 100% of the purchase price of the property because it had not previously owned any interest in the property.

Alternative arguments

Common law principle that a person cannot dispose of property to themselves

36. Under common law, a person cannot convey or dispose of property to themselves or contract with themselves: *Rye v Rye* [1962] AC 496 (HL); *Ellis v Kerr* [1910] 1 Ch 529; *Napier v Williams* [1911] 1 Ch 361; *De Tastet v Shaw* (1818) 1 B & Ald 664.

37. It has been suggested that the general law principle that a person cannot dispose of property to themselves applies where a person contributes an asset to a general partnership, with the consequence that there is only a partial disposal of the asset to the partners who had no prior interest in the asset.

38. It is the Commissioner's view that the potential application of this general law principle cannot arise in the context of the contribution of an asset to a limited partnership as a capital contribution. This is because the disposal of the asset is from one separate legal person to another and, therefore, there is no disposal of property from a person to themselves.

39. In the context of general partnerships, it is the Commissioner's view that this general law principle has no application because s 56 of the Property Law Act 2007 abrogates the general law principle that a person cannot dispose of property to themselves. Section 56 of the Property Law Act 2007 provides that a person may dispose of an estate or interest in property to themselves, alone or jointly with some other person, and that such a disposition is enforceable in the same manner as a disposition to another person. The Property Law Act 2007 applies to property to the extent that the law of New Zealand applies to the property, unless a provision of the Property Law Act 2007 is inconsistent with a provision in another enactment, in which case the provision in the other enactment prevails: s 8(1), (2) and (4) of the Property Law Act 2007.

40. For the purposes of the Property Law Act 2007, "disposition" includes any sale, transfer, exchange, or assignment, and includes the creation of any interest in property: s 4 of the Property Law Act 2007. Where a person contributes an asset to a partnership as a capital contribution, the contribution is a valid and enforceable disposition. This is because there is a transfer of the asset from the person, as owner, to the partners, as joint owners and, further, because the contribution involves the creation of beneficial interests: s 56 of the Property Law Act 2007.

41. The Commissioner also notes, for completeness, that it is well-settled law that the principle that a person cannot dispose of property to themselves is in any event qualified for income tax purposes. For example, it is settled law that where a taxpayer transfers an asset from a (taxable) trading account to a (non-taxable) private account, or vice versa, the taxpayer is treated as disposing of, or acquiring, the asset for market value: *Sharkey (Inspector of Taxes) v Wernher* [1955] 3 All ER 493 (HL); *Bernard Elsey Pty Ltd v Commissioner of Taxation* (1969) 121 CLR 119 (HCA); *Case A27* (1974) 1 NZTC 60,245; and *CIR v Farmers' Trading Co Ltd* [1982] 1 NZLR 449 (CA).

The common law mutuality principle

42. The common law mutuality principle provides that a person cannot make a profit from trading with themselves. The application of the principle generally arises in the context of co-operative type associations, where both mutuality and transactions of a mutual character are present – that is, the collective dealing of the members of the association as a group and individual dealings of members with the group for their mutual benefit. In the context of a group of persons, the essence of the principle "is an association of persons who have joined together not for trade or profit but to achieve through their mutual contributions a common end or benefit in which all members participate or are entitled to participate".

43. The Commissioner's view is that the mutuality principle has no application to the full or partial disposal question. This is because:

   - A partnership is the relation that subsists between persons carrying on business in common with a view to profit. Consequently, mutuality, which requires persons to associate not for trade or profit but for a common end or benefit, is not present in a partnership.
   - The contribution of an asset to a partnership as a capital contribution is not a mutual transaction because the contributor is not making the contribution in their capacity as a member of the partnership.

Rose, Neil, and Seven Mile

44. The Commissioner is aware of the view that *Rose v FCT* [1951] 84 CLR 118 (HCA), *Neil v Inland Revenue Commissioner (NZ)* (1967) 14 ATD 509 and *Seven Mile* support the partial disposal approach. However, the Commissioner considers, for the reasons mentioned below, that these cases are not determinative of the full or partial disposal issue in the New Zealand context.

Rose

45. In *Rose*, the High Court of Australia was concerned with ss 36(1) and 59(2) of the Australian Income Tax Assessment Act 1936–48 (ITAA 36) (which respectively applied where a taxpayer "disposed of" trading stock and depreciable property) and whether, for the purposes of those sections, there had been a full, a partial or no disposal of assets. The taxpayer had introduced, as a capital contribution, assets, including livestock, plant and machinery, of his existing grazing business to a general partnership, comprised of the taxpayer and his two sons. The Court at pg 123 expressed the issue as whether:

   > the transmutation of the property in the assets from the sole property of the taxpayer to the co-ownership of him and his two sons as partners in equal shares involve[d] a disposal of the livestock and of the depreciable property for the purposes of [ss] 36(1) and 59(2) respectively.

46. The Court said that the resolution of the issue depended on the meaning of the expression "disposed of" in each section. It considered that each section was directed at the disposal of the "entirety of ownership in the assets and not the conversion of single ownership into collective ownership" or the creation or transfer of an undivided share or fractional interest in the assets: *Rose* at 124. The Court held that the investing of the property in the assets in the three partners did not involve a disposition of the assets within the meaning of ss 36(1) and 59(2) of the ITAA 36. This was because the taxpayer, as partner, retained an interest in the assets. Therefore, the taxpayer had not disposed of the entirety of the property in the assets.

47. It is the Commissioner's view that *Rose* does not assist in answering the question considered in this item. This is because *Rose* is limited to its specific statutory context and stands as authority only for the meaning of the words "disposed of" in ss 36(1) and 59(2) of the ITAA 36. Further, *Rose* contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person's interest in an asset will fundamentally change when a person introduces an asset to a partnership as a capital contribution.

Neil

48. The reasoning of *Rose* was applied in New Zealand in *Neil*, a case in which the taxpayer and his brother owned, in equal shares, livestock used in a farming business and where the taxpayer sold his half interest to his brother. The issue was whether the taxpayer had assessable income from the sale of his half-interest in the livestock under s 98(7) of the Land and Income Tax Act 1954, a section materially similar in wording to s 36(1) of the ITAA 36.

49. The Court considered that the reasoning in *Rose* applied because of the similarity of the material words in s 36(1) of the ITAA 36 and s 98(7) of the Land and Income Tax Act 1954, despite the fact that *Rose* concerned a disposal from single ownership into collective ownership and *Neil* concerned a disposal in the opposite direction. The Court held that s 98(7) of the Land and Income Tax Act 1954 did not apply because that section applied to the disposal of only "trading stock" and not to a disposal of a share or an interest in trading stock. The Court also considered that the amendment in 1966 of s 98(7) of the Land and Income Tax Act 1954 so that it applied to the disposal of a share or an interest in trading stock indicated that the section, as it stood at the time of the taxpayer's sale of his half-interest, did not apply to a sale of a fractional share in trading stock.

50. The Commissioner considers that *Neil* does not assist in answering the full or partial disposal question considered in this item. This is because, firstly, since the taxpayer disposed of a half interest, the issue of whether there had been a full or partial disposal of the asset was not (and, on the facts, could not be) in issue. Secondly, like *Rose*, *Neil* is limited to its specific statutory context, which the Court held required a disposal of the whole asset for the provision in issue to apply. Thirdly, also like *Rose*, *Neil* contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person's interest in an asset all fundamentally change when a person introduces an asset to a partnership as a capital contribution. Fourthly, it did not involve the disposal of an asset to a partnership as a capital contribution.

51. For completeness, the Commissioner notes that it is her view that neither s EB 24 (the provision in the Act that corresponds to s 98(7) of the Land and Income Tax Act 1954 as amended) or s EE 2 of the Act are relevant to the question considered in this item. Although these provisions provide that the trading stock and depreciation rules apply to the disposal of a share or interest in trading stock or depreciable property that is co-owned, these sections do not answer or inform the question of whether there has been a full or partial disposal where an asset is contributed by a person to a partnership as a capital contribution.

Seven Mile

52. In *Seven Mile*, the Supreme Court of British Columbia held that there was a partial disposal, for the purposes of the Social Services Tax Act, RSBC, 1960, where a vendor general partnership had sold assets to a purchaser general partnership in which the vendor partnership held a 50% partnership share. On appeal, the Court of Appeal for British Columbia affirmed the decision of the Supreme Court: *Seven Mile Dam Contractors v British Columbia* (1980) 116 DLR (3d) 398.

53. The Commissioner acknowledges that *Seven Mile* could possibly be viewed as providing some support for the partial disposal view where an asset is contributed to a general partnership. However, it is the Commissioner's view that *Seven Mile* provides no real assistance to resolving the full or partial disposal issue in a New Zealand context. This is because *Seven Mile*, like *Rose* and *Neil*, contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person's interest in an asset all fundamentally change when a person introduces an asset to a partnership as a capital contribution.

Other considerations

54. It is the Commissioner's view that the full disposal approach produces outcomes that are sensible and workable, which is in contrast to the logical challenges and compliance issues that arise under the partial disposal approach.

55. The Commissioner observes that the partial disposal approach appears to give rise to an inherent inconsistency since, under this approach, only part of an asset is disposed of, but, nonetheless, the whole of the asset is treated as partnership property. It is difficult to understand how, on the one hand, the partners hold, as joint owners, 100% of the whole asset as partnership property when, on the other hand, the person has disposed of only part of the asset. If the person has not disposed of part of the asset (in the sense of creating beneficial interests in the asset), it would appear that the partners can have no joint beneficial ownership interest in that part of the asset that the person has not disposed of. The Commissioner notes that this inconsistency does not arise under the full disposal approach. Furthermore, the Commissioner notes that the partial disposal view is inconsistent with how partnerships actually, in practice, treat assets that have been contributed as capital contributions – that is to say, as having been fully disposed of to the partnership with the effect that the entire asset is

treated as partnership property. This can lead to schematic issues in relation to how the rules in subpart HG in the Act are intended to work. For example, where the asset that is 'partially' contributed is revenue account property for the contributor and is held by the partnership on capital account and the partnership treats the entire asset as partnership property.

56. The Commissioner is also aware that the partial disposal approach can, in practice, give rise to non-compliance. This occurs where the contributor of the asset overlooks the obligation to account for tax on the part of the asset they have treated, for tax purposes, as being retained by them when the asset is subsequently disposed of by the partnership.

Conclusion – there is full disposal when an asset is contributed to a partnership as a capital contribution

57. It is the Commissioner's view that where a person owns an asset and contributes that asset to a general partnership or to a limited partnership as a capital contribution, there is a full disposal of the asset by the person to the partnership under partnership law and general law.

58. Where the asset is contributed to a general partnership, this is because:
    - Neither s HG 2 nor any other provision in the Act applies to determine whether there is a full or partial disposal, so partnership law and the general law apply to determine the issue.
    - The legal ownership of the asset, its juristic character, and the person's interest in the asset, all fundamentally change.
    - Before disposal, the person is the owner of the asset.
    - Once the person has introduced an asset into a partnership as a capital contribution, the asset ceases to be the person's property. It belongs to the partners of the partnership and becomes partnership property.
    - The asset belongs to the partnership - not in the sense that each partner individually owns a separately identifiable part of the asset, but in the sense that the partners are the joint owners of the whole asset.
    - Following disposal, the person ceases to have any beneficial interest in the asset that is qualitatively different to that of the person's co-partners, and the asset must be used by the partners exclusively for the purposes of the partnership.
    - A disposal of property by a person to themselves, alone or jointly, is valid and enforceable.
    - There has been a disposal of the whole asset by its sole owner to joint owners.

59. Where the asset is contributed to a limited partnership, this is because:
    - Neither s HG 2 nor any other provision in the Act applies to determine whether there is a full or partial disposal, so partnership law and the general law apply to determine the issue.
    - There has been a disposal of the asset from one separate legal person, the person who owned the asset, to another separate legal person, the limited partnership.
    - The limited partnership, as a separate legal person, has not held any interest in the asset before the disposal of the asset to it.

Example

The following example is included to assist in explaining the application of the law.

60. James has been carrying on business as an owner–driver for a logistics company. He purchased a truck for $150,000, which he has been using in his business. His friend Fiona has identified a business opportunity in the logistics market, so she and James have formed a general partnership to carry on a logistics business. They have agreed that James will contribute his truck, which has a current market value of $125,000 and a book value of $100,000, as his capital contribution to the partnership, and Fiona will contribute $125,000 in cash as her capital contribution to the partnership.

61. In the income tax year that James contributes his truck to the partnership, he will have depreciation recovery income of $25,000 because he has fully disposed of his interest in the truck. James now owns the truck in partnership with Fiona, and the truck has ceased to be his property. As partnership property, the truck must be used for the business of the partnership.

62. If James and Fiona had established a limited partnership, instead of a general partnership, the same depreciation outcome would arise for James. This is because James would have fully disposed of the truck to the limited partnership, a separate legal person to James, and the limited partnership, as the new owner of the truck, would not have owned any previous interest in the truck.

References

Subject references

capital contribution of asset, partner, partnership, limited partnership

Legislative references

Income Tax Act 2007, ss EB 24, EE 2, HG 2 – HG 12, YA 1
Limited Partnership Act 2008, ss 6, 8, 11, 28, 31, 37, 38
Partnership Act 1908, ss 7, 8, 12, 23
Property Law Act 2008, ss 4, 8, 56

Case references

Bernard Elsey Pty Ltd v Commissioner of Taxation (1969) 121 CLR 119 (HCA)
Bieber v Teathers Ltd (in liquidation) [2012] 2 BCLC 585 (Ch)
Bieber v Teathers Ltd (in liquidation) [2013] 1 BCLC 248 (CA)
Case A27 (1974) 1 NZTC 60,245
CIR v Farmers' Trading Co Ltd [1982] 1 NZLR 449 (CA)
CIR v Dormer (1997) 18 NZTC 13,446 (HC)
De Tastet v Shaw (1818) 1 B & Ald 664 (KB)
Edenvale Restoration Specialists Ltd v British Columbia 2013 BCCA 85
Ellis v Kerr [1910] 1 Ch 529
Federal Commissioner of Taxation v Australia Music Traders Association (1990) 94 ALR 407 (FCA)
Fletcher v Income Tax Commissioners [1971] 3 All ER 1185
Hadlee v CIR [1991] 3 NZLR 517 (CA)
Hadlee v CIR [1993] 2 NZLR 385 (PC)
Meyer & Co v Faber (No 2) [1923] 2 Ch 421
Napier v Williams [1911] 1 Ch 361
New Zealand Plumbers' Merchants Ltd v CIR (1986) 8 NZTC 5,136
Neil v Inland Revenue Commissioner (NZ) (1967) 14 ATD 509
R v Holden [1912] 1 KB 483
Rose v FCT [1951] 84 CLR 118 (HCA)
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Sharkey (Inspector of Taxes) v Wernher [1955] 3 All ER 493 (HL)

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"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11

QUESTIONS WE'VE BEEN ASKED

Commissioner's operational position on QB 17/09 - *Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?*

The purpose of this item is to inform taxpayers of the operational position being adopted by the Commissioner in relation to this matter.

The Commissioner of Inland Revenue has released QB 17/09 - *Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?*

QB 17/09 clarifies the Commissioner's position due to uncertainty about whether there is a full or partial disposal of an asset where a person contributes an asset they own to a partnership as a capital contribution. Both of these approaches were previously accepted by the Commissioner.

The Commissioner's position, as confirmed in QB 17/09, on the full or partial disposal issue is that there is a full disposal of the asset. This means, for example, that where the asset disposed of is either depreciable property or revenue account property (which includes trading stock) for the person, the person may have an amount of depreciation recovery income or depreciation loss, or income or loss, calculated on the basis that the person has fully disposed of the asset.

As the Commissioner's position has changed, the Commissioner will apply the following transitional operational position:

(i) Where a person has applied a partial disposal approach (prior to the date of publication of QB 17/09) to a particular asset contributed to a partnership, and that asset is still held by the partnership, they can continue to apply that approach to the asset provided that:

- the partial disposal is recorded/noted in the person's relevant accounts for each year until the asset has been disposed of by the partnership; and
- the person must account for any applicable tax liabilities on the retained part of the asset when the partnership disposes of the asset.

(ii) Where a person has previously applied a full disposal approach to a particular asset already contributed to a partnership, they will continue to apply this approach with no change.

(iii) Where a person wants to contribute a new asset to a partnership, they must use the full disposal approach from the date of publication of QB 17/09.

QB 17/10: Income tax and fringe benefit tax – Insurance – Group insurance policy taken out by employer for the benefit of an employee

This Question We've Been Asked (QWBA) considers the income tax and fringe benefit tax treatment of group insurance policies taken out by an employer for the benefit of its employees. This insurance may be term life cover, accident/medical cover, or both. To the extent that policies contain income protection insurance, which may be included in some personal accident/ medical insurance policies, they are not considered.

Question

What is the income tax treatment of a group insurance policy that has all the following features?

- **The policy owner is the employer.**
- **The employer pays the premium.**
- **The insured persons are the employees of the employer.**
- **The employer holds the insurance policy for the benefit of the employees of the employer.**
- **The insurance is term life cover, accident/medical cover, or both.**
- **The risk insured against is the death, permanent disablement, accident, disease or sickness of the employee(s).**
- **The claim amount will either be paid to the employer by the insurer on the happening of the relevant event (death or accident or medical event), and then passed on to the relevant employee (or their estate), or paid directly to the employee at the direction of the employer.**

Answer

The employer will generally be entitled to a deduction for the premiums paid.

The premiums paid will be subject to fringe benefit tax (FBT).

Amounts paid out under the group insurance policy will not be income of the employer.

Lump sums paid out on death under a term life insurance policy will not be taxable income of the employee (or the employee's estate). Amounts paid out (or that an employee is otherwise entitled to) under accident/medical cover policies will be income of the employee only if they are income under ordinary concepts (s CA 1(2)). Amounts that are not income under ordinary concepts will not be subject to tax.

Amounts that are income under ordinary concepts may be exempt income under s CW 34 if they are paid to a person because they (or another person) are incapacitated for work and the payment is not calculated according to loss of earnings.

Explanation

1. During a review of all *Public Information Bulletins* (see **http://www.ird.govt.nz/technical-tax/pib-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). Those PIBs covered a number of different scenarios. We have replaced the PIBs with a series of QWBAs covering common scenarios.
2. This QWBA considers group insurance policies with the features listed in the Question above. References in this QWBA to group insurance policies taken out for the benefit of employees also refer to policies taken out where the insured person is an employee's spouse, civil union partner, de facto partner, or child.
3. Term (or temporary) life insurance pays out the sum insured (as a lump sum) if the life insured dies during the term of the policy. Many different types of insurance policies could be accident/medical insurance (or could include an element of accident/medical insurance). These include medical insurance, income protection insurance, accident insurance, and trauma or critical illness policies. This QWBA does not consider policies to the extent that they provide income protection insurance. Pay outs under these insurance policies can be periodic or lump sum and can be calculated in a variety of ways. Where a policy provides multiple types of cover, it may be necessary to apportion the claim proceeds.
4. All legislative references in this item are to the Income Tax Act 2007 unless stated otherwise.

Deductibility of premiums for employer

5. 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 assessable (and/or excluded) income (s DA 1). Section DA 2 sets out some limitations on deductibility. For example, expenditure that is capital in nature, or expenditure incurred in deriving exempt income, is not deductible (s DA 2(1) and (3)).

6. In most cases, salary and wage costs will be deductible because they will satisfy the nexus test in s DA 1 and none of the general limitations will apply. The payment of a premium for a group insurance policy that is paid in connection with the employees' employment is a business cost just like salary or wages. Therefore, provided the costs of an employee's salary or wages are deductible, the costs of paying the insurance premiums will be too.

When amount of premium is subject to FBT

7. Under s CX 2, a "fringe benefit" is a "benefit" that is provided by an employer to an employee in connection with their employment (s CX 2(1)(a)), and is either one of the specified benefits listed in ss CX 6, CX 9, CX 10, or CX 12 to CX 16, or is an unclassified benefit under s CX 37 (s CX 2(1)(b)). Some benefits are excluded from being fringe benefits by specific provisions in subpart CX (see s CX 2(1)(c)). Therefore, it is necessary to determine whether a "benefit", that is either a specified benefit or an unclassified benefit, arises for employees when an employer takes out a group insurance policy, and whether any of the exclusions apply.

8. Where an employer takes out a group insurance policy with the intention of holding it for the benefit of the relevant employees (or their estates) such that the employees have an enforceable right to the claim amount, the Commissioner's view is that a trust relationship will arise. The employer is the trustee, and the employer holds the group insurance policy for the employees, who are the beneficiaries. Employers commonly use group insurance policies in this way to attract and retain employees. Information about the insurance is often, but not always, made available to employees.

9. The Commissioner's view is that the provision of the group insurance policy in this situation is a "benefit" to the employees. It provides an economic advantage to the employees as it gives them benefits (coverage under the policy) to which they would otherwise not be entitled.

10. The only potentially relevant specific provision is s CX 16. Section CX 16 applies when an employer pays a "specified insurance premium" or makes a contribution to the insurance fund of a friendly society for the benefit of an employee (s CX 16(1)). "Specified insurance premium" is defined in s CX 16(3) as follows:

    Meaning of specified insurance premium

    (3) In this section, **specified insurance premium** means a premium paid for the benefit of an employee on an insurance policy to the extent to which the insurance policy is for—

    (a) life insurance under section EY 8 (Meaning of life insurance) on the life of the employee or their spouse, civil union partner, or de facto partner, or on their joint lives, or on the life of their child:

    (b) accident or medical insurance referred to in section EY 8(3) on the life of the employee or their spouse, civil union partner, or de facto partner, or on their joint lives, or on the life of their child:

    (c) insurance against accident, disease, or sickness, whether fatal or not, suffered by the employee, their spouse, civil union partner, or de facto partner, or their child.

11. The Commissioner considers that most group insurance policies will fit within the requirements of s CX 16(3). On this basis, the payment of the premium will be a fringe benefit under s CX 16. However, if a group insurance policy does not come within s CX 16, it will still be an unclassified benefit under s CX 37. Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not covered and are not excluded by a more specific provision.

12. The only potentially relevant FBT exclusion in subpart CX is s CX 31, which deals with income protection insurance. This QWBA does not consider income protection insurance. On that basis, this exclusion will not apply.

13. Therefore, provided the group insurance policy is provided in connection with an employee's employment, the provision of a group insurance policy in the situation covered by this QWBA will satisfy the requirements of s CX 2, and there will be a "fringe benefit". As a result, the employer will be liable for FBT on the premiums paid.

Income tax treatment of proceeds – employer

14. Where the employer holds the group insurance policy on trust for the employees, the relevant employee beneficiary will have an absolute entitlement to any claim proceeds, such that those proceeds will vest in the employee. As the employer does not receive the claim proceeds for the employer's benefit, those claim proceeds cannot be income of the employer.

Income tax treatment of proceeds – employee

15. Whether a payment made under an insurance policy is taxable will depend on what it is paid for. Some payments will not be income (under a specific provision or ordinary concepts) and, therefore, will not be taxable. Payments that are "income" may be either assessable or exempt income depending on the circumstances. The following discussion is intended to help decide how a payment under an insurance policy should be treated.
16. There are no specific provisions that apply to make payments under term life or accident/medical insurance policies income. Therefore, payments under these policies will be income only if they are income under ordinary concepts (s CA 1(2)).
17. Whether a payment under an insurance policy is income or not will depend on the relationship between the payer and the recipient and the purpose of the payment (*Reid v CIR* (1985) 7 NZTC 5,176). Where a payment is made to replace income which the recipient would otherwise have earned or where the purpose of the payments is to provide the recipient with amounts to meet their living expenses, the payments are likely to be income. Payments that are regular or recurring are much more likely to be income (*Reid*). However, a one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).
18. Therefore, the payments that are most likely to be income are payments that are intended to compensate an insured person for lost income (whether periodic, or lump sum) and other regular or periodic payments intended to help the insured person meet their living expenses. Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made under a term life policy, or a payment reimbursing medical expenses).
19. Payments that are not "income" will not be taxable. If a payment is "income", it is necessary to consider whether it is assessable income or exempt income.
20. The relevant exemption provision is s CW 34. A payment made to a person because they (or another person) are incapacitated for work will be exempt under s CW 34 if it is a payment by a friendly society, or a payment of income made under a policy of personal sickness or accident insurance and the payment is not calculated according to loss of earnings. If the payment does not meet these criteria, it will be assessable income.
21. The Commissioner considers that it will be rare for payments received by employees under a policy of the type considered by this QWBA to be "income" but not subject to the exemption in s CW 34.
22. Payments received for a claim under an insurance policy will not be subject to FBT.
23. The following examples are included to help explain the application of the law.

Examples

Example 1 – Term life cover

Judith's employer takes out a group term life insurance policy with the lives insured being the employer's senior employees. Judith is one of the senior employees covered by the policy. The employer intends that the policy will be held for the benefit of the employees. The senior employees are informed about the existence of the policy, and their entitlements under the policy, in their "Employee Welcome Pack". There is also a page on the employer's intranet that discusses the entitlements of the senior employees under the group insurance policy.

Judith's employer is allowed a deduction for the premiums. The premiums are subject to FBT because a fringe benefit arises under s CX 16.

Judith contracts a terminal illness that is covered by the group insurance policy. Judith's employer receives a $200,000 payment under the policy, which it passes on to Judith.

The $200,000 payment is not income of the employer. The employer only receives this amount as trustee for Judith. The $200,000 is also not income for Judith. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Judith for lost income.

Example 2 – Accident cover

Bill's employer takes out a group accident/medical insurance policy with the lives insured being the employer's employees. The employer intends that the policy will be held for the benefit of the employees. This is demonstrated by the fact that the policy documents indicate that it is for the benefit of the employees. In addition, the terms of the policy allow the employees to elect to have additional voluntary cover, and to transfer the cover should the employee leave their employment.

Bill's employer is allowed a deduction for the premiums. The premiums are subject to FBT because a fringe benefit arises under s CX 16.

Bill suffers an accident where he breaks his leg and has to undergo various medical procedures. Bill's employer receives a $1,000 payment, which it passes on to Bill as a reimbursement for Bill's medical expenses.

The $1,000 is not income of the employer. The employer only receives this amount as trustee for Bill. The $1,000 is also not income for Bill. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Bill for lost income.

References

Subject references

FBT
Fringe benefit
Insurance

Legislative references

Income Tax Act 2007, ss CA 1, CW 34, CX 2, CX 9, CX 10, CX 12 - CX 16, CX 31, CX 37, DA 1, DA 2

Case references

FCT v Hyteco Hiring Pty Ltd 92 ATC 4,694
Reid v CIR (1985) 7 NZTC 5,176

Other references

"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 17/03: Loss offset elections between group companies

Introduction

Standard practice statements (SPS) describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This statement sets out certain practices that the Commissioner will accept for offsetting losses by election between group companies. It also sets out the consequences of specific events that can impact on a loss offset and how these should be addressed.

The SPS does not consider all questions relating to loss offsets within a group of companies and accordingly is not a fully comprehensive guide to Subpart IC of the Income Tax Act 2007.

Application

This statement applies from 14 December 2017 and replaces SPS 05/12 *Loss offset elections between group companies* published in *Tax Information Bulletin* Vol 18, No 1 (February 2006).

Standard Practice

Summary

1. The purpose of the loss offset provisions is to allow those companies that incur losses to utilise those losses even where different entities are involved. This means that there is similarity in the tax treatment of a group of companies, each carrying on separate enterprises, as compared with a single company that carries on the same enterprises in separate divisions.
2. This SPS sets out the application of certain pre-requisites and other aspects of loss offset provisions in Subpart IC which allow loss offset elections to be made. It discusses the requirements for giving notice, the Commissioner's practice with respect to part-year losses, and explains what should happen when the loss company's loss or the profit company's net income is increased or reduced. It also sets out the requirements for there to be a valid election and/or subvention payment.
3. A loss company must be resident in New Zealand in terms of section IC 7. The loss company must have maintained a 49% continuity of ownership from the time of the loss to the time of the offset. The profit companies and the loss company must have at least 66% common ownership. The amount of loss offset(s) will be limited to the amount of profit(s) in the profit companies. The amount must be fixed by the election in a manner that binds the electing company, but need not be quantified in the election. Refer to paragraphs 14 to 16 for more detail in this area.
4. The loss company must notify the Commissioner of an election for the loss offset and where applicable of a subvention payment within the timeframe under section IC 9 of the Income Tax Act 2007. The election may be notified in a tax return or separately from the tax return. Where an extension to the timeframe for filing the election is sought. In this case the request for the extension must be sought from and approved by the Commissioner before an offset can be made.

Detailed discussion

5. Subpart IC provides for the sharing of losses between companies that are in the same group of companies. A company may make its tax loss available for subtraction from the net income of another group company. There are two methods of sharing losses which may be used together.
6. The first is for the loss company to notify an election in its tax return for the loss to be made available to the profit company. Any such election is irrevocable. That election must be notified to the Commissioner no later than the 31 March that follows the end of the loss company's year of offset, or within such further time as the Commissioner may allow: section IC 9(2).

7. Another method of sharing a loss is for the profit company to make a "subvention payment" to the loss company. A subvention payment made to the loss company is offset against the profit company's net income and reduces the loss company's available net losses. The payment to the loss company and notice to the Commissioner by the loss company of that payment must be made no later than the 31 March that follows the end of the loss company's year of offset, or within such further time as the Commissioner may allow: sections IC 9(1) and (2).
8. Previously the Commissioner took the view that a subvention payment required actual payment to be made. However, from December 2010 the Commissioner's position is that in the absence of any statutory definition of "payment" in the context of subvention payments, the following principles will apply:
   a) The ordinary meaning requires a discharge of obligations between parties.
   b) There are a number of ways in which an obligation may be discharged including payment in cash or its equivalent or by certain accounting entries.
   c) Payment may be made by accounting entries where they cause a genuine crediting in the payee's account or set off a pre-existing obligation. Making a journal entry will not be generally sufficient to cause a "payment" unless there is a clear agreement between the parties that this will satisfy the obligation.
9. Consequently, in the subvention payment context, "payment" will be satisfied when the obligation under the subvention payment agreement has been discharged. The obligation can be discharged by an actual cash payment, cheque or bank transfer. Other methods of discharging an obligation can also amount to "payment". An obligation will generally be discharged where the payee can no longer sue the payer for the payment. It should be noted that an Accounting Entry that merely records an intention to pay a subvention payment will not in itself amount to a "payment". Also, simply resolving to pay a subvention payment does not amount to creating an enforceable obligation.

Example 1

A loss company has an obligation to pay a debt to a profit company for past purchases from the profit company. The profit company resolves to make a subvention payment to the loss company. The profit company and the loss company decide to allow the subvention payment to be applied in satisfaction of the Loss Coy's past debt. An accounting entry is made to record this. The accounting entry is treated as the payment of the subvention payment.

10. As stated above, this SPS sets out the application of certain aspects of loss offset provisions in Subpart IC which allow loss offset elections to be made. It discusses the requirements for giving notice, the Commissioner's practice with respect to part year losses, and explains what should happen when the loss company's loss or the profit company's net income is increased or reduced. It also sets out the requirements for there to be a valid election. Where this statement discusses elections, it is equally referring to notices of subvention payments made.
11. The election may be included in the loss company's income tax return or made separately from the tax return. An election must be made by the latest time to file a loss company's income tax return. The Commissioner has discretion to accept a late election to offset losses beyond an agreed extension of time ("EOT") to file the return.
12. The Commissioner must approve the application to apply the discretion and agree to make the loss offset. The mere processing of the return and issuing the taxpayer's notice of assessment do not amount to an exercise of the discretion by the Commissioner to accept a late loss offset election.

Prerequisites

13. Before a loss offset can proceed the following factors must be present.

Loss company

14. There must be a company with a tax loss for an income year or a loss balance carried forward. The loss company must have 49% continuity of ownership from the time the loss is incurred until the loss is offset: sections IA 5(2), (3) and (6).
15. The loss company for the commonality period under section IC 6(1) must be incorporated in New Zealand or be carrying on a business in New Zealand through a fixed establishment in New Zealand.
16. The loss company for the commonality period under section IC 6(1) must not be a dual resident company, that is, though resident in New Zealand it must not be:
    - treated under a double tax agreement as not being resident in New Zealand for the purposes of the double tax agreement, or
    - liable to income tax in another country by reason of domicile, residence or place of incorporation: section IC 7.

Profit company

17. There must be one or more profit companies in the same group of companies as the loss company, and all companies must be in the same group of companies for the whole continuity period as defined in section IA 5(6). Whether or not two companies form a group of companies is outside the scope of this SPS. A group of companies must have at least 66% common ownership. More detailed guidance on common ownership can be found in the Interpretation Statement: *IS 13/02 Income tax – whether certain rights conferred by the Companies Act 1993 could give rise to a "shareholder decision-making right"*.[1]

Amount of loss

18. The amount of loss to be offset must not exceed the net income of the elected profit company for the tax year, or the total net income of all the elected profit companies. Nor can the amount of subvention payment that the profit company agrees to pay the loss company exceed the loss company's tax loss: sections IC 8.

A specific amount

19. An election should refer to an amount that is capable of identification as a specific dollar amount. The amount must be fixed by the election in a manner that binds the loss company, but need not be quantified in the notice of election. That is, a formula may be used where the result of applying that formula could be known at the time of the election. For example, the election might provide that the tax loss to be offset is to be such an amount that would reduce the profit company's net income to nil.

Example 2

In a group consisting of two companies, it is found, once its accounts have been prepared, that company A has a tax loss of $10,000. It is anticipated that Company B will be in profit and that the amount of the net income will be about $2,000, ie less than the amount of Company A's tax loss. However, Company B's accounts have still to be prepared as the accountants are waiting on further information from their clients. That information will be arriving in a few days. There is still time to file an election and the question is whether Company A can now elect to offset some of its loss up to the amount of the profit company's net income by using a formula.

This is permissible because:

- the Commissioner will be notified in time
- the amount will be subsequently identified as a specific dollar amount
- it does not matter that (even if the accounting firm could commit staff to the finalisation of the accounts) the net income cannot be ascertained with finality at the time of making the election
- the amount to be offset is already fixed in that it is controlled by the formula.

The election

20. An election to offset the tax loss must be notified by the loss company. The loss company can give notice of election by:
    - completing the appropriate boxes in the loss company's income tax return, or
    - completing the appropriate boxes in the loss company's e-filed income tax return, or
    - sending a separate notice to the Commissioner. These notices need to set out the names and IRD numbers of the relevant companies as well as the respective amounts (or formula for calculation of the amounts) of net loss to be offset.

Late elections and extensions of time for filing them

21. An election must generally be made by 31 March in the year following the year of loss offset (that is, in the year to March 31 when the offset is elected). However, the Commissioner can agree to a later date for the election: section IC 9(2). The notification of the election may be made in the [late] return, or by separate notice. Note that in the case of a subvention payment, the payment must also be made within the same time for notifying the Commissioner of the election: section IC 9(1).

22. In considering an application to apply this discretion, the Commissioner will be mindful of the purpose of the loss offset regime which is to allow those companies that incur losses to utilise those losses even where different entities are involved. There should be similarity in the tax treatment of a group of companies, each carrying on separate enterprises, as compared with a single company that carries on the same enterprises in separate divisions. A case need not be exceptional for the

[1] More information on this statement can be found at **www.ird.govt.nz** (search keyword: "IS 13/02").

discretion to be exercised favourably. The Commissioner will generally extend the timeframe required to make loss offset elections where a loss offset would be allowed. However, where the loss company has already taken a tax position that does not provide for a loss determination, an amendment to that tax position will be required to apply any subsequent loss offset election. It is logical that the same rationale that relates to an amendment under section 113 of the TAA, should be applied to the discretion to extend the date for making an election. This means that where an amendment to an assessment under section 113 would be denied, the Commissioner would not extend the timeframe for notifying a late loss offset election.

23. To summarise this aspect, the decision to exercise the discretion to notify the late loss offset election will be based on whether the loss offset will be allowed. If the loss offset will be allowed, then the discretion will be exercised. Where the loss company is seeking to amend a position already taken with regard to the loss offset, the discretion will only be exercised where the approval under section 113 of the TAA will be applied with regard to the loss offset election.

Example 3

A request to extend the date for making a loss offset election is filed on 10 April after 31 March of the year following the year of loss offset. The reason given for requesting the extension is that although the loss company's income tax return had been prepared and filed sometime previously there were numerous profit companies in the group and the preparation of those returns had taken time. Consequently, the income tax returns for the profit companies had been filed late. The loss company made no loss offset election within the time for the loss company to file their income tax return. Section 113 of the TAA would not be applied to allow a loss offset. As such, the timeframe for notifying the loss offset election would not be extended.

Further elections

24. Once a loss company has made an election, it cannot withdraw that election or change any part of that election. It is final and irrevocable: section IC 5(4). However, further elections can be made in some cases, for instance a loss company is not limited to a single election in respect of only one profit company. As already highlighted, it must be remembered that any further elections would be treated as a request to amend an assessment under section 113.

Part-year losses

25. It is possible to offset a part-year loss (section IP 4) provided the following requirements as set out in section IP 4(2) are met:
    - the tax loss component arises in the common span (as defined in section IP 2(1)), and
    - the amount of the tax loss component is no more than the net income that the profit company derives in the common span, and
    - continuity of ownership in the loss company under section IC 2(1) applies from the beginning to the end of the common span, and
    - the loss company and the profit company provide the Commissioner with adequate financial statements under section IP 6. These accounts should contain sufficient information to indicate the calculation of the amount of the company's net income for the relevant part of the corresponding income year. The Commissioner's view is that the financial statements are required to be prepared in accordance with the generally accepted accounting practice, adjusted for the purposes of income tax legislation, at the level required under the Financial Reporting Act 2013 and the Tax Administration (Financial Statements) Order 2014. This does not require the preparation of notes to the accounts and disclosure statements. The part-year accounts will of necessity be different from full year accounts due to different ratios, denominators etc, and
    - a valid loss offset election (section IP 7) within the timeframes required for elections under section IC 9.

26. Where a company has a break in shareholder continuity part way through a month and its accounting system balances and reports at the end of the month, subject to the taxpayer backing out significant transactions pre or post the change in continuity, Inland Revenue will accept the use of the end-of-month balance sheet figures for determining provision balances. Inland Revenue will also accept pro-rata allocation of the month's income and expenditure to determine the pre and post continuity change in net income or loss.

27. In some cases it may be difficult to prepare part-year accounts to the level of detail set out above, particularly where there has been a significant lapse of time since the loss of shareholder continuity for the part-year. In such circumstances, taxpayers may discuss their individual positions with Inland Revenue and depending on the facts a different approach may be agreed upon.

Amended assessments

28. In some cases Inland Revenue may amend an assessment for a profit or loss company resulting in increased or reduced net income or losses respectively. As a consequence there may be a need for further elections for additional loss offsets. There are four situations that may be brought about by amended assessments. These are:
    - the available loss is reduced below the amount originally elected to be offset
    - the available loss is increased
    - the profit company has additional net income that could be the subject of an offset, and
    - the profit company has reduced net income below the level of the amount of the loss offset.

Reduced loss

29. Where the loss company's assessment is amended (having its loss reduced below the level in the loss offset election) and as a consequence is not entitled to offset the amount elected then the following action will be taken:
    (i) where there is only one profit company then the Commissioner will, usually after consultation with the company or its agent, simply amend the assessment for the profit company in accordance with section 113 of the TAA. No further election is necessary as the assessment of the profit company will reflect the reduced loss available to be offset, and
    (ii) where there is more than one profit company the loss company will need to notify Inland Revenue as to how that reduced loss is to be allocated to the profit companies pursuant to section IC 11(3). If the loss company does not make this subsequent election within 6 months of the loss company being notified that it's tax loss is reduced or within such further time as the Commissioner may allow, the reduced loss is allocated proportionately to the original amount of the loss offset allocated to each profit company: section IC 11(4).
30. In the case where the reduction results in a subvention payment being treated as a dividend in the hands of the loss company, the dividend may be reduced to the extent this portion of the subvention payment is repaid to the profit company within the same timeframe discussed in the preceding paragraph: section IC 11(5).

Increased loss

31. Where the loss company's assessment is amended and as a consequence has additional losses to offset, a further election can be made for those additional losses. The first election remains valid and cannot be revoked. The further election must meet all the criteria set out above for an election, for example it must be on time, state the additional amount to be offset, and name the profit company or companies. As discussed already, any amendment will be subject to the SPS 16/01 Requests to amend assessments, April 2016.

Increased profit

32. Where a profit company's assessment is amended and as a consequence has additional net income that could be the subject of an offset, a further election can be made by the loss company in respect of the additional net income within the statutory time period (set out in section IC 9(2)). This election must meet all the criteria for loss offsets. The emphasis will be on the notification of a loss offset by the loss company. It will not focus on the profit company's change in net income.

Reduced profit

33. Where a profit company's assessment is amended and as a consequence has reduced net income (below the level of the loss offset), the deduction for the profit company remains valid up to the reduced amount of the net income. The "unused" tax loss will be added back to the loss balance carried forward by the loss company. A further election can be made for the additional losses to other profit companies within the group. Any further election must meet all the relevant criteria for loss off-sets.

Requests to amend assessments

34. Changes to the assessments of the loss company or profit company may impact on the loss offset election already made and the availability of further loss offset elections. Examples are discussed in the immediately preceding paragraphs.
35. Requests will be looked at from the amending loss company's point of view. This means, for example, that the Commissioner will be considering why a loss company made an error with their initial loss offset. In that case, it may not be relevant why the profit companies' net income was amended.

36. Where there are any consequential impacts on the loss offset election and a further election needs to be made or the election needs to be revised, the taxpayer companies may need to consider whether section 113 of the TAA allows those changes to be implemented. SPS 16/01 *Requests to amend assessments* (Apr 16) (published in *Tax Information Bulletin* Vol. 28, No. 4 (May 2016)), which sets out the circumstances when the Commissioner may amend assessments to ensure correctness, is relevant in considering whether the election should be accepted.
37. It should be noted that taking tax positions that both include or exclude a loss offset are each correct tax positions. The Commissioner will not amend one correct tax position to another correct tax position unless the initial tax position was made in error. In terms of SPS 16/01, the onus will be on the taxpayer to show that this was the case.
38. It is the Commissioner's practice that having approved a further election so that the loss company's loss or the profit company's net income is increased or reduced, those amendments will be made. Generally the Commissioner will not agree to amend an assessment where the taxpayer has previously had the opportunity to offset known losses, and has failed, for whatever reason, to do so.

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.

Court confirms hardship provisions do not apply when Commissioner is pursuing bankruptcy

Case	Singh v Commissioner of Inland Revenue [2017] NZCA 506
Decision date	1 November 2017 (Reasons were provided on 13 November 2017)
Act(s)	Tax Administration Act 1994, ss 176, 177, 177C
Keywords	Judicial review, application for financial relief, hardship, apparent bias

Summary

On 1 November 2017 (reasons provided on 13 November 2017) the Court of Appeal gave judgment for the Commissioner of Inland Revenue ("the Commissioner") and dismissed the appellants' appeal against Lang J's dismissal of their application for judicial review. The appellants had sought a review of a decision by the Commissioner declining their application for financial relief.

The appellants claimed apparent bias and that the Commissioner had failed to take into account the appellants' inability to make mortgage payments.

Impact

Bankruptcy is not a debt recovery proceeding and the hardship provisions do not apply where the Commissioner is pursuing bankruptcy.

Facts

Mr and Mrs Singh (the appellants) appealed against Lang J's dismissal of their application for judicial review of a decision by the Commissioner declining their application for financial relief.

On several occasions between January 2014 and 2015, the appellants had unsuccessfully sought financial relief from paying their tax debts on the grounds of serious hardship. This led them to file judicial review proceedings. Before the scheduled hearing, the Commissioner agreed to reconsider her decision and the proceedings were vacated by consent.

Mr Philp (the collections manager with delegated authority) considered and declined the fresh application, which had first been the subject of a report and recommendation by Ms Law which had also been reviewed by two other Inland Revenue officers. The appellants were dissatisfied with the outcome and filed an amended statement of claim which was heard and dismissed by Lang J in December 2016.

Decision

First ground of appeal – apparent bias

The appellants contended that Lang J was wrong to dismiss their complaint that Mr Philp (as delegated decision maker) was disqualified from participating in the reconsideration process because of apparent bias. The Court considered this contention is "hopeless".

The Court held that the mere fact that Mr Philp had previous involvement fell far short of apparent bias. The Court held that the allegation should not have been made on a manifestly inadequate foundation.

The Court agreed with Lang J that there was no basis on which a reasonable and fair-minded observer might reasonably apprehend that Mr Philp would not bring an impartial and open mind to his responsibility to determine the further relief application.

Second ground of appeal – alleged failure to take account of the appellants' apparent inability to make mortgage payments

The appellants also contended that the Commissioner had failed to take into account their failure to make mortgage repayments. The Court held that the appellants' pleading on this ground was inadequate with no more than a bald conclusory assertion with no facts or circumstances pleaded in support. The Court stated that the inadequacy of the pleading may be explained by the fact that the claim is baseless.

Decision and concluding observations

The Court was satisfied that the appellants' complaints against the Commissioner were "completely unjustified" and rightly rejected by Lang J.

The Court turned to the legislative provisions for granting relief. The Court confirmed the constraints of s 176 of the Tax Administration Act 1994 ("TAA"):

1. The Commissioner may not recover outstanding tax if this would be an inefficient use of her resources; and
2. The Commissioner may not recover outstanding tax where recovery would place the taxpayer in serious hardship.

The Court noted that s 177C(1) of the TAA provides that the Commissioner *may* write off outstanding tax that cannot be recovered. The Court further noted however that s 177C(1BA) makes it clear that there is no obligation to do so, even where recovery of the outstanding tax would place the taxpayer into serious hardship.

The appellants' request for financial relief did not involve any proposal for payment and faced with the option of either writing off the entire debt and receiving nothing, or pursuing bankruptcy, the Commissioner was entitled to pursue bankruptcy, which would enable the Official Assignee to take control of the appellants' financial affairs.

The Court also commented on the decision of Toogood J in *P v Commissioner of Inland Revenue* [2015] NZHC 229 and particularly paragraphs [30]-[49]. The Court considers that bankruptcy proceedings are not properly characterised as debt recovery proceedings. Accordingly there is no obligation on the Commissioner to write off outstanding tax and she may pursue bankruptcy proceedings where appropriate.

Taxation Review Authority confirms the Commissioner's ability to attribute income to a non-party in a transaction

Case	A v Commissioner of Inland Revenue [2017] NZTRA 08
Decision date	30 November 2017
Act(s)	Tax Administration Act 1994 ss 89A, 138G, Income Tax Act 2007 ss BD 3, CA 1, (CB 6, CB 7)
Keywords	Issue exclusion, onus and standard of proof, allocation of income, income under ordinary concepts

Summary

The disputant taxpayer had benefited from international money transfers, foreign currency purchases and domestic transfers and card expenditure which the Commissioner of Inland Revenue ("the Commissioner") considered had been conducted on the disputant's behalf through trusts and companies wholly owned and operated by the disputant's friend. The Taxation Review Authority ("the Authority") largely confirmed the Commissioner's assessments but found that certain isolated transactions had an insufficient link with the disputant and accordingly disallowed those amounts.

Impact

This is a useful decision which confirms that income amounts can be attributable to a non-party to a particular transaction pursuant to s BD 3(4) of the Income Tax Act 2007 ("ITA"), where there is a genuine case for suggesting that the amounts have been dealt with on the person's behalf or in his or her interest.

The Authority's finding is particularly helpful in determining that in attribution cases the onus and standard of proof remains unaffected and the Commissioner has no duty to undertake particular enquiries on behalf of the taxpayer. This is so even when the documents relating to the transaction underpinning the assessment are not in the taxpayer's immediate possession but held by the parties directly involved in the transaction.

The decision otherwise applies the standard principles regarding what constitutes income under ordinary concepts.

Facts

The disputant is a New Zealand citizen and tax resident, who during the disputed period (the 2005 to 2011 income years) spent considerable time in Australia where his family has lived permanently since 2001. He was bankrupted in both 1993 and 2003. The disputant filed nil income tax returns following the issue of default assessments. He did not return any income in Australia in the disputed period.

It was common ground that the disputant was involved in property trading and land development as a consultant during the disputed period. He primarily provided his consultancy services in connection with the business dealings of his father and two childhood friends "Mr Green" and "Mr Jones" ("his associates"). The Commissioner assessed deposits and expenditure of trusts and other entities of his associates as income to the disputant because she considered he received them in exchange for consultancy services provided. Other deposits from unknown sources into the disputant's personal bank account and the bank account of a related trust "the K Discretionary Trust" have also been assessed as income to the disputant.

Some of the disputed amounts were not received directly by the disputant but were amounts paid into bank accounts held in the names of the disputant's family members, payments to third parties, or expenditure via an eftpos card for expenses which were clearly of a personal nature.

Decision

Process issues

Alternative taxing theory

The Authority found that the primary basis for the Commissioner's assessment had always been income under ordinary concepts.

The Authority rejected the disputant's contention that the approach taken by the Commissioner was not clear until after the issue of the adjudication report, discovery and the receipt of the investigator's brief of evidence. Both the primary ground (income under ordinary concepts) and the alternative ground (income pursuant to ss CB 6 and CB 7 of the ITA) had been clearly set out in the Commissioner's Notice of Response. The Authority therefore found that any issues which the disputant wished to raise relating to the Commissioner's basis of assessment could have been included in the disputant's Statement of Position ("SOP").

Furthermore, the Authority found that even if the issue did not arise until after the adjudication report was issued, the requirements of s 138G(2)(b) would not be met, as any issues with the assessments could have been satisfactorily addressed in the *de novo* hearing before the Authority. Therefore the Authority concluded that the disputant would not suffer any manifest injustice if the issue was not raised.

Provision of information

The Authority noted that the disputant had been provided with a breakdown of the assessed amounts and source documents for Mr Green's entities prior to the issue of his SOP. The Authority determined that it was reasonable for the Commissioner to assume the disputant could source for himself his own personal bank statements (which he knew the Commissioner had copies of) as well as his family members' bank statements and the statements of the K Discretionary Trust.

The Authority found that, even if it could be argued that the disputant did not know of documents held by the Commissioner or was not able to raise this process issue at the time he issued his SOP, the disputant would not suffer manifest injustice if the issue is not raised.

The Authority went on to hold that the Commissioner did not have a duty to undertake particular enquiries effectively on behalf of the disputant. Neither was there any basis for holding the Commissioner to a higher standard to assist a disputant in attribution cases. Accordingly, it was determined that the requirements of s 138G(2)(b) were not met and the disputant's application was dismissed.

Substantive issues - Income under ordinary concepts

The Authority noted that the character of income under ordinary concepts required consideration of a number of factors, including regularity of payments and the recipient's reliance on them to meet living expenses. The Authority quoted from *Dunn v Commissioner of Inland Revenue* ((1979) 1 NZTC 61,245 (SC)) and noted that amounts can be income derived by a person in spite of him or her not being the immediate recipient of the money or money's worth, if the income has been dealt with on the person's behalf or in his or her interest.

Credibility issues

The disputant claimed that some of the amounts attributed as income to him were either loans to him from his father, repayments of loans from his father to Mr Green or loans from Mr Green to the disputant. He did not produce any supporting documents in evidence. The Authority was clear in finding that the disputant was not a credible witness and considered the disputant's description of his various business activities vague and unconvincing. Accordingly, the disputant's explanations that the amounts were loans were not accepted.

Findings for the Commissioner

The Authority found that the disputant had failed to discharge the onus in respect of the vast majority of the amounts assessed. Many amounts had also been conceded by the disputant during the final stage of the hearing.

The disputant's travel in and out of New Zealand coincided with the foreign currency purchases and the use of an eftpos card connected with Mr Green's entities. The disputant's acceptance and concession that he had used the card both for business and personal expenditure and estimate that 50% of the amounts assessed might be attributable to him, was not sufficient to discharge the onus.

International transfers from Mr Green's entities to the disputant's family members were also found to be income attributable to the disputant. The disputant had not called any family members, or Mr Green, to give evidence. International transfers from Mr Green's entities to third parties in Australia were also attributed as income to the disputant.

The majority of the amounts which had been transferred to the disputant's personal bank accounts and the bank account of the K Discretionary Trust were also held to be income to the disputant.

Findings for the taxpayer

The Authority found that one deposit for AUD $519,351.45 from X Marine Services into the disputant's Australian bank account was not assessable as income to the disputant. The disputant's evidence was that this amount was the sale proceeds from the disposal of his father's boat. The Authority found that the amount, being a one off substantial payment which could reasonably be inferred to be from the sale of a boat, did not have the quality of income under ordinary concepts. On the same basis, two deposits totalling $66,300 from the same entity into the K Discretionary Trust were also found not assessable.

Two further transactions of $10,020 and $12,020 from Mr Green's entities to an entity in Phuket were also found not to be income attributable to the disputant because the Authority considered that there was insufficient basis for their inclusion in the assessment (not being transfers to Australia, where the disputant lived with his family).

The Authority upheld the remainder of the Commissioner's assessments which totalled $7,024,988.76 (The total amount still disputed going into the final stage of the hearing, including the amounts which the Authority found not assessable as income to the disputant.)

High Court lacks jurisdiction to review where there is no exercise of a statutory power of decision

Case	Muir v The Taxation Review Authority & Anor [2017] NZHC 2932
Decision date	29 November 2017
Act(s)	Judicature Amendment Act 1972; Judicial Review Procedure Act 2016
Keywords	Protest to jurisdiction, strike out, abuse of process

Summary

The Applicant ("Dr Muir") brought proceedings in the High Court seeking to judicially review the Taxation Review Authority's ("TRA") refusal to accept for filing his "Second Amended Notice of Claim". This proceeding concerned the Commissioner of Inland Revenue's ("the Commissioner") application to dismiss Dr Muir's judicial review application.

Impact

This decision confirms that where a tax challenge has been struck out in its entirety, there is no jurisdiction to judicially review a refusal to accept an amended notice of claim for filing in the struck out challenge.

Facts

The background to the proceeding involves the Trinity tax scheme designed by Dr Muir. The High Court determined that the dominant purpose of the scheme was tax avoidance (*Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC)), which decision was affirmed by the Court of Appeal (*Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230) and Supreme Court (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115).

Dr Muir's challenges to the 1997 to 2010 income years, which had been stayed pending the outcome of the Supreme Court's decision, were subsequently struck out in the TRA and High Court. This was affirmed on appeal by the Court of Appeal (*Muir v Commissioner of Inland Revenue* [2015] NZCA 792) and by the Supreme Court (*Muir v Commissioner of Inland Revenue* [2016] NZSC 113) which determined that Dr Muir's proceedings remained struck out in their entirety. Dr Muir then tendered 'amended statements of claim' in the TRA and the High Court. The TRA refused to accept the amended pleading for filing while the High Court inadvertently accepted the amended pleading for filing.

The High Court, in separate proceedings on the inadvertent acceptance for filing, had declared the tendering of the amended statement of claim in High Court was an abuse of process and a nullity, directing that the document be removed from the file (*Muir and Hillvale Holdings Ltd v Commissioner of Inland Revenue* [2017] NZHC 2082). Dr Muir brought these proceedings seeking to judicially review the TRA's refusal to accept the amended pleading for filing and the Commissioner applied for these proceedings to be dismissed.

Decision

The High Court was satisfied it did not have jurisdiction to review the TRA's refusal to accept Dr Muir's "Second Amended Notice of Claim" for filing and dismissed the application pursuant to r 5.49(6)(a) of the High Court Rules.

The Court found, citing the earlier High Court decisions (*Commissioner of Inland Revenue v Muir* [2017] NZHC 1413, (2017) 28 NZTC 23-029 at [44] and *Muir v Commissioner of Inland Revenue* [2017] NZHC 2082, (2017) 28 NZTC 23-029 at [12]), that as the proceeding in the TRA is at an end, there is nothing in which any 'amended' pleading may be filed. As the TRA did not exercise any power in refusing to accept such a pleading for filing, the High Court was satisfied that it did not have jurisdiction to review such a refusal.

Given the Court's finding, it did not need to decide the Commissioner's alternative application to strike out the judicial review as an abuse of process. However, the Court noted that had it been required to, it would have granted it.

The Court's preliminary view was the Commissioner should be entitled to 2B costs for all steps before 23 June 2017 and indemnity costs from 23 June 2017 when summary judgment was ordered against Dr Muir (*Commissioner of Inland Revenue v Muir* [2017] NZHC 1413) but reserved leave for memoranda on costs to be filed if required.

Judicial review proceeding alleging bias struck out

Case	Tamihere v The Commissioner of Inland Revenue [2017] NZHC 2949
Decision date	30 November 2017
Act(s)	High Court Rules 2016 r 15.1; District Court Rules 2014 r 1.24; Crimes Act 1961 s 219; Insolvency Act 2006 ss 101, 117; Judicial Review Procedure Act 2016 s 8
Keywords	Apparent bias, vexatious, standing, strike out, judicial review

Summary

Mr Tamihere, a current bankrupt, filed a statement of claim and an affidavit in support seeking a judicial review of actions taken by Judge Andrée Wiltens ("the Judge") during a civil list hearing in the Manukau District Court on 12 June 2017. The Commissioner of Inland Revenue ("the Commissioner") applied to have the matter struck out on the basis that it disclosed no reasonably arguable cause of action, was frivolous, vexatious and an abuse of the Court's process.

Impact

The decision applies the standard principles governing strike-out.

Facts

At the list hearing under challenge, Mr Tamihere had asked for the Court to direct the Crown Counsel appearing on behalf of the Commissioner to provide proof that they had standing to appear on behalf of the Commissioner. The Judge dismissed Mr Tamihere's request/application.

Mr Tamihere alleged in his application for judicial review:

1. The Judge exceeded his statutory authority and violated the principles of justice when he stated Crown Counsel did not have to produce proof of standing in Court;
2. The Judge evidenced bias toward the applicant and the proceeding was *coram non judice* which again amounted to an abuse of process;
3. The Judge acted ultra vires when he refused to provide Mr Tamihere with a copy of the Commissioner's sworn statement granting the Court subject matter jurisdiction; and
4. The proceeding was void and the Court lacked jurisdiction to hear it.

Mr Tamihere alleged breaches of ss 25 and 27 of the New Zealand Bill of Rights Act 1990 and sought $15,000 in damages as a result of those alleged breaches.

Decision

The Court granted the Commissioner's strike out application and dismissed the proceeding.

The Court held that nothing within the transcript attached to Mr Tamihere's supporting affidavit provided any basis for a finding of bias, actual or apparent, in relation to the Judge's actions. The Court found there was no foundation in law or fact for any allegation that the Judge exceeded his statutory authority, or acted in a manner amounting to bias or violation of natural justice or abuse of process. The Court held that the proceeding as a whole was frivolous, vexatious and an abuse of the court process.

As the Court was already satisfied that the proceeding be struck out on the earlier grounds, the Court held that it did not need to consider the more complex question of whether the District Court can ever be liable in damages for breaches of the Bill of Rights in view of the Supreme Court's decision in *Attorney-General v Chapman* ([2011] NZSC 110, [2012] 1 NZLR 462).

For the same reason, the Court determined it did not need to come to a conclusion on deciding whether the applicant, as an undischarged bankrupt, had standing to bring this proceeding.

Deductibility under s DB 55(1)

Case	NRS Media Holdings Ltd v Commissioner of Inland Revenue [2017] NZHC 2978
Decision date	1 December 2017
Act(s)	Income Tax Act 2007 section DB 55
Keywords	Tax deductions, Expenditure, incurred, income dividend

Summary

NRS Media Holdings Ltd ("NRS") sought to claim deductions under s DB 55 of the Income Tax Act 2007 ("ITA"), for expenditure incurred by its head office in managing NRS' subsidiaries that periodically pay NRS dividends. The Commissioner of Inland Revenue ("the Commissioner") disallowed the deductions and NRS challenged the Commissioner's assessment.

The High Court found DB55 requires expenditure to be factually and causally incurred in the derivation of foreign dividend income. The expenditure claimed was insufficiently related to the derivation of foreign dividends which was one step removed from the purpose of the expenditure; which was to increase subsidiary value.

Impact

The test for deductibility under s DB 55(1) requires the taxpayer to show the expenditure has been incurred in deriving the dividend. A nexus showing only a connection between the expenditure and the carrying on of the business from which the dividend is derived is insufficient to satisfy the requirements.

It is noted that s DB 55 was retrospectively repealed by the Taxation (Annual Rates, Employee Allowances and Remedial Matters) Act 2014 effective 30 June 2009 for income years beginning on or after 1 July 2009, therefore this decision has limited impact going forward.

Facts

NRS is a New Zealand resident parent company of subsidiaries incorporated in various foreign jurisdictions. The subsidiaries provide and maintain systems that facilitate the sales of radio and television advertising space by their clients. The NRS Head Office has at all material times been located in Sydney, Australia, and consisted of a Chief Executive, Chief Financial Officer and four support personnel.

NRS sought deductions for the costs incurred over the course of two tax years by its Head Office, on the basis of foreign subsidiary expenditure. The deductions sought totalled $3,670,040.54 and were made up of the following elements:

1. The salaries of the six staff;
2. The rent of the office in Sydney;
3. Telephone and other communication costs; and
4. Travel and overseas accommodation costs for the Chief Executive and Chief Financial Officer.

The Commissioner proposed to disallow the deductions on the grounds that NRS had not incurred the expenditure in deriving dividend income.

The matter was later referred to the Disputes Review Unit and the Adjudication Report concluded that the claimed deductions were not allowed under s DB 55. Assessments were issued on this basis which NRS challenged.

Decision

The Court briefly discussed the relevant statutory framework including the calculation of assessable income, the 'general permission' for allowable deductions under s DA(1), and the 'exempt income limitation' which excludes deductions for amounts incurred in deriving exempt income. Dividends received from foreign subsidiaries are exempt income under s CW9(1) of the ITA.

Under s DB 55, the exempt income limitation may be overridden. It allows a company that derives a dividend from a foreign company to deduct expenditure incurred by the company in deriving that divided.

S DB 55(1)

NRS argued s DB 55 did not bear the narrow interpretation advanced by the Commissioner, and contrary to the Commissioner's approach, there is no requirement for the expenditure to be directly linked in some positive way, nor factually and causally directed. Rather, the taxpayer must establish the costs in question were "incurred in the course of" deriving the income.

The Commissioner argued a 'narrower' scope for s DB 55 that concerns itself with expenditure incurred in the operation of a taxpayer in earning its income, not expenditure incurred in operation of a subsidiary. The expenditure focussed on improving subsidiary and was only indirectly linked to deriving dividends.

There is no case law on DB55 but a substantial amount on the 'general permission' in s DA 1. The Authorities recognised the distinction between the first and second limb of s DA 1. Given the materially similar terms of DB55(1) to the first limb of s DA 1, the High Court considered there is no basis for placing a different construction on each.

Section DB 55 does not contain an equivalent of the second limb of the General Permission, which allows deductions for expenditure incurred in the course of carrying on a business for the purpose of deriving income. The deductions allowed under s DB 55 are available only in respect of those expenses incurred in deriving dividends. NRS had to establish that its expenditure factually and causally was directed at deriving a foreign dividend.

Assessment

Justice Clark found the expenditure claimed was insufficiently related to the derivation of foreign dividends and was one step removed from the purpose of the expenditure which was to increase the subsidiary value.

The evidence provided by NRS showed the expenditure provided services to the subsidiaries to maximise the value of each subsidiary and therefore its profitability. The first consequence of the expenditure was to improve the subsidiaries and a further consequence was the receipt of foreign dividends. Deriving dividends was an ancillary consequence of the increasing profitability and value of the subsidiaries.

Expenditure in order to maximise value and profitability of companies returning dividends is not deductible under DB55. Such expenditure might fall within the second limb of the general permission but not within the more restricted scope of s DB 55.

Accordingly, NRS' foreign subsidiary expenditure is not deductible and the Commissioner's assessments were confirmed.

Attempt to relitigate matters previously determined struck out as an abuse of process

Case	Tamihere v The Commissioner of Inland Revenue [2017] NZHC 3012
Decision date	6 December 2017
Act(s)	Judicature Amendment Act 1972; Tax Administration Act 1994, s109
Keywords	Strike out – abuse of process – standing – bankruptcy – strike-out

Summary

Mr Tamihere filed judicial review proceedings which appeared to seek to revisit a 2012 District Court decision ("the Civil decision") granting the Commissioner of Inland Revenue ("the Commissioner") judgment against Mr Tamihere for unpaid tax debt as well as decisions resulting in criminal convictions and sentence. The Commissioner applied to strike out the proceeding.

Impact

The Decision applies the standard principles governing strike-out applications.

Facts

Mr Tamihere was the sole director of Rags 2 Go Limited ("Rags 2 Go"). Mr Tamihere had also operated as a sole trader in the same field within which Rags 2 Go operated.

Rags 2 Go was placed into liquidation in June 2011 on the basis, primarily, of unpaid PAYE. Rags 2 Go was removed from the register in June 2014.

While operating as a sole trader, Mr Tamihere, either himself or through a tax agent filed self-assessed GST returns and PAYE deductions were assessed as owing based on Employer Monthly Schedules provided by Mr Tamihere and/or his tax agent.

The statutory disputes procedures under Part 4A and 8A of the Tax Administration Act 1994 ("TAA") were not engaged in to dispute or challenge the assessments. In August 2012 the Commissioner obtained judgment against Mr Tamihere for $199,737.12, being the total unpaid tax debt as at that date.

Mr Tamihere filed an application for leave to appeal out of time which was dismissed in 2013. In August 2013 Mr Tamihere was adjudicated bankrupt on the Commissioner's application. An application seeking a stay of the bankruptcy order was dismissed as was a further document treated as an application for recall of the bankruptcy decision. An application to annul the bankruptcy in June 2014 was also struck out.

In January 2014 Mr Tamihere was convicted of charges relating to PAYE and sentenced to home detention in October 2014. Mr Tamihere appeared not to have sought to exercise any right of appeal against his convictions or sentence.

In April 2017 Mr Tamihere filed judicial review proceedings against the Commissioner, Attorney-General and District Court. The claim made wide-ranging allegations of corruption and breaches of human rights but failed to specify the particulars or factual basis for the claims.

Decision

The Court granted the Commissioner's application to strike out the statement of claim and dismiss the proceeding on the basis there was no reasonably arguable cause of action and it was also an abuse of process.

The Court took the view the application was primarily directed at the Civil decision however Mr Tamihere was also challenging the decisions resulting in his criminal convictions and bankruptcy.

The Court held there were no grounds upon which Mr Tamihere might challenge his convictions or sentence, finding the complaint of double jeopardy relating to the criminal convictions was based on a misunderstanding of the matters considered by the District Court in the Civil decision. The Court noted that while that proceeding resulted in a determination that Mr Tamihere was required to repay a debt to the Commissioner, it so happened his actions in relation to that debt were also a criminal offence.

The Court noted Mr Tamihere's challenge to the Civil decision amounted to a challenge to the tax payable which was only able to be challenged through the statutory disputes process, and Mr Tamihere had raised no factual basis to suggest it could not practically be invoked.

The Court found none of the alleged procedural and jurisdictional errors raised in respect to the civil proceedings had any factual foundation or basis. Rather the Court found they were based on misunderstandings of the legal process and earlier proceedings.

The Court noted most if not all of the claims had already been addressed and dismissed in decisions of other judges, as summarised by the Court in its decision. The Court considered the present claim to be a further attempt to relitigate matters already determined and was an abuse of process.

The Court also found there was no foundation to any of the allegations made against other respondents (including various Ministers and public servants) named by Mr Tamihere and no proof of service of the proceedings in relation to those respondents. The Court found there was no reasonably arguable cause of action maintainable against any of those other respondents, the proceeding against them was an abuse of process and it was appropriate to strike it out.

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