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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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IN SUMMARY

New legislation

Families Package (Income Tax and Benefits) Act 2017 2

This new legislation received Royal assent on 20 December 2018. Three key tax-related measures were enacted. Best Start was introduced to replace the Parental Tax Credit, Tax cuts planned by the previous government were cancelled and the Independent Earner Tax Credit reintroduced, and Working For Families Tax Credits were changed to better target assistance to low and middle income families.

Questions we've been asked

QB 18/01: Can a fit-out of an existing building be "improvements" for the purposes of s CB 11? 7

This Question We've Been Asked sets out the Commissioner's view that a fit-out of an existing building may constitute "improvements" for the purposes of s CB 11. This means that if a person is in the business of erecting buildings (or is associated with someone in that business), and they do a fit-out of an existing building, and sell that building within 10 years of completing the fit-out, the sale proceeds may be taxable under s CB 11.

Standard practice statements

SPS 18/01: Retrospective adjustments to salaries paid to shareholder-employees 11

This statement sets out the process for considering whether the circumstances are appropriate for the Commissioner to agree to retrospectively alter an amount of shareholder's salary, irrespective of whether this alteration increases or decreases the original amount of shareholder's salary.

Legislation and determinations

National standard costs for specified livestock determination 2018 17

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2017-2018 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

Legal decisions - case notes

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Associate Judge Matthews was satisfied that the interests of creditors would be safeguarded by interim liquidators being appointed, as the assets are in jeopardy.

Notices issued under s 17 of the Tax Administration Act 1994 held to be invalid 20

Chatfield & Co Ltd and Chatfield & Co applied to judicially review a decision of the Commissioner of Inland Revenue to issue 15 Notices to Furnish Information under s 17 of the Tax Administration Act 1994 to it ("the Notices"). A partially successful strike out application left one cause of action (being an alleged failure to take into account the terms of a double taxation agreement between the Republic of Korea and New Zealand) to proceed to a substantive hearing. The High Court found that cause of action was made out and granted the application for judicial review, quashing the Notices.

When does the response period to issue a NOR start following the Taxation Review Authority's decision that a NOPA should have been accepted out of time? 22

The Taxation Review Authority concluded that s 89AC of the Tax Administration Act 1994 applied to this dispute and that the Commissioner of Inland Revenue's ("the Commissioner") Notice of Response ("NOR") was issued within the requisite response period. Even if s 89AC was not applicable, the Commissioner's NOR was issued within the response period under s 89AB (prior to amendment). Furthermore, even if it was not, there has been no deemed acceptance of the disputant's Notice of Proposed Adjustment by the Commissioner under s 89H(2).

Part of claim that did not comply with strict procedural requirements struck out by Taxation Review Authority 24

The Taxation Review Authority upheld an application by the Commissioner of Inland Revenue ("the Commissioner") to strike out those parts of the disputant's Notice of Claim that related to the Commissioner's 2011 reassessment of a GST return filed by the disputant in 2008.

NEW LEGISLATION

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

Families Package (Income Tax and Benefits) Act 2017

The Families Package (Income Tax and Benefits) Act 2017 was introduced as an omnibus Bill 14 December 2017, enacted on 15 December 2017 and received Royal assent on 20 December 2017.

The Act gives effect to substantial aspects of the Government's Families Package, part of its 100 day plan. It replaces the previous Government's Budget 2017 Family Incomes Package.

The Families Package is designed to provide targeted social assistance to improve incomes for low and middle-income families with children, and to reduce child poverty. It is part of the Government's focus on ensuring children get the best start in life and complements other legislation to increase the number of weeks of paid parental leave from 1 July 2018 and 1 July 2020.

The Package also provides income support for some families without children through the reinstatement of the independent earner tax credit, the introduction of the Winter Energy Payment, and some changes to Accommodation Supplement.

The Act amends Working for Families Tax Credits, introduces two new payments (Best Start and the Winter Energy Payment), and repeals the Taxation (Budget Measures: Families Incomes Package) Act 2017 which included income tax threshold changes and Working for Families Tax Credits changes.

The changes to the revenue acts are in Part 1 of the Families Package (Income Tax and Benefits) Act 2017 and are covered in this item.

INTRODUCTION OF BEST START

Sections GB 44, HR 8, MA 1, MA 5 to MA 8, MB 2, MC 1, MC 5, MC 6, MC 10, MC 11, MD 11, MF 1, MF 2, MF 4, MF 7, subpart MG, and section YA 1 of the Income Tax Act 2007; sections 3, 24F, 41, 80KB, 80KC, 80KD, 80KK, 80KN, 80KO, 80KP, 80KU, 80KV, 80KW, 85I, 89C and 185 of the Tax Administration Act 1994. The Act also amends schedule 2 of the Housing Restructuring and Tenancy Matters Act 1992; sections 3 and 61G of the Social Security Act 1964; clause 13 of the Privacy (Information Sharing Agreement between Inland Revenue and Ministry of Social Development) Order 2017; clause 1 of the Taxation (Abated Interim Payments of subparts MA to MF and MZ Credit) Regulations 2002.

Best Start is a new payment introduced as part of the Government's Families Package and will replace the Parental Tax Credit. It will provide extra support to all families in the first year of a child's life and for low and middle income families, support until the child turns three. The focus is on the first three years given the importance of this period for a child's development, but also because this is when many families struggle to manage care, and often work responsibilities. This provides support for longer than the Parental Tax Credit which is only payable for the first 10 weeks after the birth of a child.

More families will be eligible to Best Start than the Parental Tax Credit. Best Start will be available to families receiving a main benefit, whereas the Parental Tax Credit is not. Best Start will also be available to families who have received paid parental leave, once the paid parent leave entitlements have ended. Families who receive paid parental leave are ineligible for the Parental Tax Credit.

Key features

Best Start introduces a payment of $3,120 per year for children born, or due to be born, on or after 1 July 2018.

Best Start replaces the Parental Tax Credit.

Detailed analysis

The Best Start tax credit is a new Working for Families Tax Credit. New subpart MG in the Income Tax Act 2007 provides for the payment.

Entitlement to Best Start tax credit

New section MG 1 provides the Best Start tax credit entitlement criteria. It provides that the payment will be available to principal caregivers of a dependent child if:

- the person meets the qualifying criteria for Working for Families Tax Credits (for example, that they are over 16 years of age and resident);
- the dependent child is aged less than 3 years old; and
- the child is born (or due to be born) on or after 1 July 2018.

Best Start amount

New section MG 2 provides that the Best Start tax credit amount is $3,120 per child per year. The section sets out how the payment is adjusted for entitlement periods of less than a year or when the care of the child is shared.

It also provides for the continuation of Best Start payments for four weeks following the death of a child.

This section also allows for the amount of the tax credit to be altered by Order in Council.

Indexation provisions for Best Start

Section MF 7 has been amended to provide that the Best Start tax credit amount is adjusted (by Order in Council) when the Consumers Price Index (CPI) all groups (excluding cigarettes and tobacco) cumulatively reaches 5% from 1 July 2018. The amount will be subsequently increased each time the movement in the CPI reaches 5%, as measured from the date of the previous change.

Abatement settings

New section MG 3 provides that the Best Start tax credit will be unabated in the child's first year – that is, all qualifying families will receive the full amount in the child's first year. For children aged one and two, the tax credit will be subject to abatement at the rate of 21 cents in the dollar on family income over $79,000.

This section also allows for the abatement threshold and rate to be altered by Order in Council.

Protected Best Start

New section MG 4 ensures a person will receive full (i.e. unabated) payments of Best Start each month the person receives an income tested benefit. This mirrors provisions already in place for the family tax credit.

Best Start a Working for Families Tax Credit

The Income Tax Act 2007 has been amended to ensure that the rules applying to the Working for Families Tax Credits also apply to Best Start. This includes amending the definition of Working for Families Tax Credit in section MA 8 to include the Best Start tax credit under new section MG 1.

Section MC 6 of the Income Tax Act 2007 ensures that the Best Start tax credit is not payable for a child at the same time as the parental tax credit, paid parental leave or a parent's allowance, or children's pension payable under the Veteran's Affairs Act 2014.

Section YA 1 changes the definition of dependent child, so that a person who receives an Orphan's Benefit, Unsupported Child Benefit, or Foster Care Allowance for a child is able to claim that child as a dependent child for Best Start.

Parental tax credit

The new Best Start tax credit replaces the parental tax credit on and after 1 July 2018. As a result, section MD 11 has been amended so that the parental tax credit is not paid for children born on or after 1 July 2018. Section MD 11 has also been amended to allow a person to elect to receive the parental tax credit, instead of the Best Start tax credit, if the child has an expected due date on or after 1 July 2018 but is born before 1 July 2018.

Amendments to the Tax Administration Act 1994

The Tax Administration Act 1994 has been amended to ensure the administration and instalment payment provisions applying to Working for Families Tax Credits also apply to the Best Start tax credit.

To remove unnecessary compliance burdens if a person expects their only tax credit entitlement in a tax year to be a Best Start tax credit for a child aged under one, they are not required to provide income details for that year.

Application date

- The Best Start tax credit comes into force on 1 July 2018 and will apply to children born on or after 1 July 2018 and to children born before 1 July 2018 when the child's expected due date was on or after 1 July 2018.
- New parents become ineligible for Parental Tax Credit from 1 July 2018.

REPEAL OF TAX CUTS

Repeal the Taxation (Budget Measures: Family Incomes Package) Act 2017

The measures contained in the Taxation (Budget Measures: Family Incomes Package) Act 2017 are repealed and replaced with a new package of measures that provides better targeted social assistance payments to low and middle-income families.

Support is also provided for families without children by reinstating the independent earner tax credit.

Key features

The Taxation (Budget Measures: Family Incomes Package) Act 2017 introduced changes that were to apply from 1 April 2018. The Act removed the independent earner tax credit and made changes to Working for Families Tax Credits by increasing the family tax credit amount for children under 16, and amended the abatement settings. It also increased the bottom two tax thresholds for income tax rates, and made various consequential amendments to ensure the personal income tax threshold changes flowed through the tax system appropriately. Further details are set out in the *Tax Information Bulletin*, Volume 29, No. 9 of October 2017.

The Families Package (Income Tax and Benefits) Act 2017 repeals these changes meaning the independent earner tax credit is reinstated and the 2017-18 year income tax thresholds and Working for Families Tax Credits settings continue from 1 April 2018 (unless otherwise amended by the Families Package (Income Tax and Benefits) Act 2017).

Detailed analysis

Independent earner tax credit

The independent earner tax credit (IETC) is reinstated. The IETC is $520 a year for people earning between $24,000 and $44,000. It abates at 13 cents in the dollar on income over $44,000 and is fully abated when income is $48,000 or more.

The eligibility rules for the IETC already exclude people eligible for Working for Families Tax Credits. Therefore, if a person (or their partner) receives the Best Start tax credit, they will not be entitled to receive the IETC. This is achieved by the new definition of *Working for Families Tax Credit* in section MA 8 of the Income Tax Act 2007 including Best Start.

Application date

- The repeal of the Taxation (Budget Measures: Family Incomes Package) Act 2017 is treated as coming into force on 29 May 2017 (the day that Act was enacted).

WORKING FOR FAMILIES TAX CREDIT CHANGES

Sections MD 3, MD 13, ME 1, MF 4D, MF 4E, MF 4F, MF 4G, MF 7of the Income Tax Act 2007; sections 2, 5 and 14B of the Taxation (Annual Rates and Budget Measures) Act 2011.

The changes to Working for Families Tax Credits support the Government's aim of providing more targeted assistance to low and middle income families with children. From 1 July 2018 it increases payments of Working for Families for those currently receiving them, and also increases the number of families who are eligible.

Key features

From 1 July 2018 the Working for Families abatement settings are amended so that payments will be subject to abatement at the rate of 25 cents in the dollar on family income over $42,700. The family tax credit amounts are increased and the age-related payment amounts are removed.

The removal of the age-related provision reduces the number of Family Tax Credit amounts to two – one for the eldest child, the other for any subsequent children, regardless of age.

The net result of these measures is that most families will have their payments increased and more families will be eligible for Working for Families Tax Credits.

Detailed Analysis

Instalment amounts during the 2018-19 year

The changes during the year mean different instalment amounts and abatement settings apply to the periods 1 April 2018 – 30 June 2018, and 1 July 2018 – 31 March 2019.

New section MF 4F provides that the instalment amounts and abatement settings for the period 1 April 2018 – 30 June 2018 are as follows:

	1 April 2018 – 30 June 2018
Eldest child, 16 – 18	$5,303
Eldest child, 0 – 15	$4,822
Subsequent child, 16 – 18	$4,745
Subsequent child, 13 – 15	$3,822
Subsequent child, 0 – 12	$3,351
Income threshold	$36,350
Abatement rate	22.5%

Age-related payments are still in force for this period. As a result section MF 4F also includes requirements to calculate a weighted average of the amounts if a child moves across age bands during the entitlement period.

New section MF 4G sets out the instalment amounts and abatement settings for the period 1 July 2018 – 31 March 2019 as follows:

	1 July 2018 – 31 March 2019
Eldest child	$5,878
Subsequent child	$4,745
Income threshold	$42,700
Abatement rate	25%

From 1 July 2018 there are no longer any age-related differences in payments, removing the requirement to calculate a weighted average payment when a child moves across age bands.

Annual entitlement for the 2018-19 year

Working for Families Tax Credits entitlements are calculated over a tax year. Given the part-year change to the abatement settings and family tax credit instalment amounts, composites of these amounts are required to determine the annual entitlement for the 2018-19 year.

Section MD 3 has been amended to provide the composite family tax credit amounts for the 2018-19 year, and section MD 13 is amended to provide the composite abatement settings. The amounts are set out below:

	1 April 2018 – 31 March 2019
Eldest child, 16 – 18	$5,734
Eldest child, 0 – 15	$5,614
Subsequent child, 16 – 18	$4,745
Subsequent child, 13 – 15	$4,514
Subsequent child, 0 – 12	$4,397
Income threshold	$41,116
Abatement rate	24.38%

Section MD 3 also includes requirements to calculate a weighted average of the amounts if a child moves across age bands during the entitlement period.

Amounts for the 2019-20 and later tax years

Sections MD 3 and MD 13 are amended again effective 1 April 2019 to provide the family tax credit amounts and abatement settings for the 2019-20 and later tax years. These are the same amounts as for the period 1 July 2018 – 31 March 2019 as set out below:

	2019-20 tax year onward
Eldest child	$5,878
Subsequent child	$4,745
Income threshold	$42,700
Abatement rate	25%

As these amounts apply to full tax years, there is no requirement for any composite rates to calculate annual entitlement.

Indexation provisions

The family tax credit increases when there is a cumulative movement in the Consumers Price Index all groups (excluding cigarettes and tobacco) of 5% since the last increase. Section MF 7 of the Income Tax Act 2007 has been amended to reset the date the movement in the index is measured from to 1 July 2018 to account for the increase to the family tax credit.

With the change in abatement threshold and abatement rate, sections 2, 5 and 14B of the Taxation (Annual Rates and Budget Measures) Act 2011 are repealed. These sections set out provisions to progressively amend the abatement threshold and rate over time and are now redundant.

Minimum family tax credit

The Minimum Family Tax Credit ensures beneficiaries with children are better off in work by topping up after-tax income to a certain threshold. The threshold has been increased from $23,816 to $26,156 from 1 April 2018, to ensure these beneficiaries will remain better off after the annual indexation of main benefit rates, and the introduction of the new Winter Energy Payment.

Application dates

- The changes to the Income Tax Act 2007 to amend the Minimum Family Tax Credit and Working for Families Tax Credits payments for the 2018-19 year come into effect 1 April 2018.
- The changes to the Income Tax Act 2007 to amend Working for Families Tax Credits payments for the 2019-20 and later years come into effect 1 April 2019.
- Redundant sections MF 4D and MF 4E of the Income Tax Act 2007 are repealed from 20 December 2017 (being the date of Royal assent).

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 18/01: Can a fit-out of an existing building be "improvements" for the purposes of s CB 11?

Unexpected tax consequences may result from the sale of an investment property for people who complete a fit-out of their property where they are in the business of erecting buildings, or are associated with someone in that business.

"Improvements", for the purposes of s CB 11, is defined as being **improvements to land** that are **not minor** and are **made by a person, or an associated person, erecting a building or otherwise**.

Question

Can a fit-out of an existing building be improvements" for the purposes of s CB 11?

Answer

Yes. A person in the business of erecting buildings (or associated with such a person) who does a fit-out of an existing building, and later sells that building, may be required to pay tax on the net proceeds of the sale under s CB 11.

Explanation

1. Under s CB 11, a person in the business of erecting buildings who makes "improvements" to land and then sells that land within 10 years of completing the "improvements", is liable for income tax on the net sale proceeds. It is irrelevant whether the land was acquired for the purpose of the person's business of erecting buildings.
2. Section CB 11 also applies in the same way to a person who is not in the business of erecting buildings themselves, but is associated with someone in the business of erecting buildings. Further information on the "associated persons" rules can be found in "New Definitions of 'Associated Persons'", *Tax Information Bulletin* Vol. 21, No 8, Pt II (October/November 2009): 75–93.
3. Section CB 11 provides:

    CB 11 Disposal within 10 years of improvement: building business

    Income

    (1) An amount that a person derives from disposing of land is income of the person if—

    (a) they dispose of the land within 10 years of completing improvements to it; and

    (b) at the time they began the improvements, they carried on a business of erecting buildings, whether or not the land was acquired for the purpose of the business.

    Income: associated person in business of erecting buildings

    (2) An amount that a person (person A) derives from disposing of land within 10 years of completing improvements on it is income of person A if another person (person B) associated with person A at the time the improvements were begun carried on a business of erecting buildings, whether or not—

    (a) person A carried on a business of erecting buildings; or

    (b) the land was acquired for the purpose of person B's business.

    Exclusions

    (3) Subsection (2) is overridden by the exclusion for bodies controlled by a local authority in section CB 15C and subsections (1) and (2) are overridden by the exclusions for residential land in section CB 16 and for business premises in section CB 19.

4. Subsection (1) applies to persons in the business of erecting buildings and subs (2) applies to landowners who are associated with a person in the business of erecting buildings. While there are some exclusions in s CB 11(3) for council-controlled organisations and for residential land and business premises, these are not covered in this item. The key requirement for triggering the section is that the landowner made "improvements".

The definition of "improvements"

5. For the purposes of s CB 11, the term "improvements" is defined under s YA 1 as:

   improvements, in … CB 11 (Disposal within 10 years of improvement: building business), means ***improvements to land*** that—

   (a) are ***not minor***; and

   (b) are ***made***—

   (i) ***by a person erecting a building or otherwise***; or

   (ii) by an associated person erecting a building or otherwise

   [Emphasis added]

6. There are three main criteria that need to be satisfied in the definition of "improvements": **improvements to land** that are **not minor** and are **made by a person erecting a building or otherwise**.

7. The term "improvements" used in the context of s CB 11 should not be confused with the term "improvement" defined under s EE 67 for the purposes of the depreciation rules.

Improvements to land

8. "Improvements" under s YA 1 must be improvements to land. Based on case law, improvements to land include any work or operations done to land that enhance the value of that land (*Case L43* (1989) 11 NZTC 1,262; *Morrison v Federal Commissioner of Land Tax* (1914) 17 CLR 498).

9. Improvements to land will often involve work or operations that add something to land, for example, the construction of a house. However, improvements to land can also involve the removal of something previously attached to land, for example, the removal of an unsafe building from land enhancing the value of that land (*Morrison v Federal Commissioner of Land Tax; McGeoch v Federal Commissioner of Land Tax* (1929) 43 CLR 277).

10. Work done to a building may be improvements to land to the extent that it involves adding fixtures or making structural changes to the building. This is because legally, a building and its fixtures are considered part of the land to which they are attached. This long-standing principle of land law is summarised in *Hinde, McMorland & Sim Land Law in New Zealand* (online looseleaf ed, LexisNexis, accessed 8 September 2017) at [6.036]:

    … whatever is affixed to the soil, belongs to the soil. Thus buildings erected on land and items permanently attached to the buildings become fixtures and a part of the land itself.

11. In most instances, building fixtures will be those items permanently attached to a building. In the context of a fit-out of an existing building, it is unlikely that items not permanently attached to the building would be classified as fixtures. Therefore, to the extent that a fit-out of an existing building involves the addition and/or removal of fixtures enhancing the value of the building, the fit-out will be improvements to the land on which the building is built.

12. However, where the work done to a building is repairs and maintenance, it is not considered to be improvements to land for the purposes of s CB 11. Interpretation Statement IS 12/03: "Income Tax – Deductibility of Repairs and Maintenance: Expenditure – General Principles" (*Tax Information Bulletin* Vol 24 No 7 (August 2012): 68-105) sets out the approach for determining whether work is repairs and maintenance or a capital improvement.

"Erecting a building or otherwise"

13. Under s YA 1, "improvements" means "improvements to land … made by a person [or an associated person] erecting a building or otherwise". The words "improvements to land … made by a person erecting a building" provide an example of the most common type of improvements to land, the erecting of a building. However, the words "or otherwise" make it clear that the erecting of a building is not the only improvements to land that can meet the definition of "improvements", and that any other improvements to land can also be included. This wide interpretation is consistent with the common law and the legislative history of s CB 11.

14. Before being rewritten in its current form, the definition of "improvements", most recently contained in s CD 1(2)(d) of the Income Tax Act 1994, was worded as "any improvements … to that land (whether by way of erecting a building or otherwise)". This earlier wording highlights that **any** improvements to land can be "improvements". The current definition of "improvements" under s YA 1 (and s OB 1 of the Income Tax Act 2004 before it) was intended to have the same effect as the wording of the definition in s CD 1(2)(d) of the Income Tax Act 1994.

"Not minor"

15. Even where improvements to land have been made by a person (or an associated person) erecting a building or otherwise, they will only be "improvements" for the purposes of s CB 11 if they are "not minor".

16. The meaning of "not minor" has previously been considered in Interpretation Guideline IG0010 "Work of a Minor Nature", *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5–23 (IG0010). IG0010 confirms that "not … of a minor nature" and "not minor" have the same meaning and effect. Although IG0010 discusses when **development or division work** is "not minor" in the context of s CB 12, the common legislative history of ss CB 11 and CB 12 suggests that similar principles will apply when determining whether **improvements to land** are "not minor" for the purposes of s CB 11.
17. When considering whether improvements to land are "not minor" for the purposes of s CB 11, an overall assessment of what was done in the particular circumstances should be made. The following factors set out in IG0010 for the purposes of s CB 12 are considered useful and relevant when deciding whether improvements to land are "not minor" for the purposes of s CB 11:
    - the importance of the improvements in relation to the physical nature and character of the land;
    - the total cost of the improvements made in both absolute and relative terms;
    - the nature of the professional services required; and
    - the nature of the work required for the improvements.

Examples

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

Example 1 – A fit-out that triggers s CB 11

Valyrian Villas Ltd is a construction company that builds homes for customers based on pre-drawn plans. It is in the business of erecting buildings. Seven years ago, Valyrian Villas Ltd purchased a two-storey office building as a rental investment separate from its building business. Valyrian Villas Ltd leased the whole office building to a law firm.

Last year, the law firm moved to larger premises and Valyrian Villas Ltd decided to do a new fit-out of the office building. The cost of the fit-out was considerable. Both floors of the building were converted from individually partitioned offices into an open plan layout. All the internal walls around each of the 20 offices were removed. The large kitchen and staff room on the ground floor were replaced by six smaller kitchenettes located around the building. The two large boardrooms were divided into smaller, soundproofed meeting rooms. The entire building also had new LED lighting and cabling for state-of-the-art information and communications technology installed. Recently, almost a year after the fit-out was completed, Valyrian Villas Ltd sold the office building. Under s CB 11, Valyrian Villas Ltd is liable for income tax on the sale of the building because:

- Valyrian Villas Ltd is in the business of erecting buildings.
- The fit-out involved the addition and removal of fixtures, enhancing the value of the office building. Therefore, the fit-out is improvements to the office building and as a consequence, to the underlying land.
- Although a question of fact and degree, Valyrian Villas Ltd's fit-out of the office building is considered to be "not minor". The completed fit-out was important in relation to the physical nature and character of the building (and therefore the land), with a marked change to the floor plan and amenities across the building as a whole. The cost of Valyrian Villas Ltd's fit-out was considerable. The nature of both the professional services and physical work required to complete the fit-out was likely to have been significant, given the extent of the changes made.
- Although the fit-out did not involve the erecting of a building, s CB 11 applies to any class of "improvements". Therefore, the fit-out comes within the "or otherwise" class of "improvements" provided for by the words "made by a person erecting a building or otherwise".
- The building was sold within ten years of the fit-out being completed.
- While there are some statutory exclusions to s CB 11, none of these are relevant to Valyrian Villas Ltd's situation (see ss CB 11(3), CB 15C, CB 16 and CB 19 for the exclusions to s CB 11).

Example 2 – A fit-out that is only a minor improvement to land

Dornish Dwellings Ltd is in the business of erecting buildings. It also owns a small retail shop that it leases to a florist. The florist's lease ends, and Dornish Dwellings Ltd looks for new long-term tenants. Sandy, a young clothing designer, approaches Dornish Dwellings Ltd and asks if he could set up a pop-up store in the shop for one month so he can sell his line of designer clothing. Dornish Dwellings Ltd agrees to lease the shop to Sandy. Dornish Dwellings Ltd fits out the now empty shop with some old shelving and clothes racks, a couple of bamboo screens for customers to change behind, and other shop furniture.

Because nothing done in the fit-out is permanently attached to the building, Dornish Dwellings Ltd has not made improvements to land. Accordingly, s CB 11 would not be triggered by Dornish Dwellings Ltd providing Sandy with the temporary fittings.

Example 3 – A fit-out that is only a minor improvement to land

North Of The Wall Limited is in the business of erecting buildings. The company decides to invest profits in an investment property and purchases a 16 floor office building for $82,000,000. Six months after North Of The Wall Limited purchased the building, the tenant that leased the fourth floor moves out. In order to attract a new tenant, North Of The Wall Limited does a fit-out of the fourth floor. The fit-out takes three months to complete and includes both the addition of fixtures at a cost of $200,000, and fittings at a cost of $50,000. The fit-out does not significantly change the overall character of the office building. Although the fit-out involves improvements (the fixtures) to land, these are considered to be minor. While the cost of the improvements in absolute terms is not insignificant, it is small relative to the overall value of the office building. The fit-out is not considered to be important in relation to the nature and character of the building (and, therefore, the land). No architectural or other professional services are used and only minimal physical work is required.

Therefore, although North Of The Wall Ltd has made improvements to land, these are considered to be minor and therefore do not meet the definition of "improvements" for the purposes of s CB 11.

Example 4 – A person associated with someone in the business of erecting buildings

Tyroshi Tenements Ltd is a property-holding company owned by Braavosi Building Ltd, a construction company. Tyroshi Tenements Ltd is not in the business of erecting buildings, but Braavosi Building Ltd is. Tyroshi Tenements Ltd has been associated with Braavosi Building Ltd for over 20 years. This year, Tyroshi Tenements Ltd sells one of its commercial properties (office block A). Importantly, eight years earlier, Tyroshi Tenements Ltd carried out a significant and costly fit-out of every floor in office block A. Although Tyroshi Tenements Ltd is not in the business of erecting buildings itself, it is still subject to s CB 11 because it was associated with Braavosi Building Ltd at the time the fit-out was begun. Therefore, assuming the fit-out of office block A was "improvements" for the purposes of s CB 11, by selling office block A this year, eight years after completing the fit-out, Tyroshi Tenements Ltd must pay tax on the sale.

References

Subject references

Business of erecting buildings
Fit-out
Improvements

Legislative references

Income Tax Act 1994: s CD 1(2)(d)
Income Tax Act 2004: ss CB 10 and OB 1 ("improvements")
Income Tax Act 2007: ss CB 11, CB 12 and YA 1 ("improvements")

Case references

Case L43 (1989) 11 NZTC 1,262
Morrison v Federal Commissioner of Land Tax (1914) 17 CLR 498
McGeoch v Federal Commissioner of Land Tax (1929) 43 CLR 277

Other references

Hinde, McMorland & Sim Land Law in New Zealand (online looseleaf ed, LexisNexis, accessed 8 September 2017) at [6.036]
"New Definitions of 'Associated Persons'", *Tax Information Bulletin* Vol 21, No 8, Pt II (October/November 2009): 75–93
"Work of a Minor Nature", *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5–23

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 18/01: Retrospective adjustments to salaries paid to shareholder-employees

This statement also appears in *Tax Information Bulletin* Vol 30, No 2 (March 2018) and on Inland Revenue's website **www.ird.govt.nz**[1]

Introduction

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

In *Tax Information Bulletin* Vol 17, No 4 (May 2005), the CIR published *Standard Practice Statement 05/05: Retrospective adjustments to salaries paid to shareholder-employees* (SPS 05/05), which addressed the question of when a retrospective reduction in a shareholder-employee's salary may be made. SPS 05/05 specifically did not address the question of when a retrospective increase in a shareholder-employee's salary could be made.

Any request received by the CIR to retrospectively alter an amount of shareholder's salary involves the CIR exercising her discretion under s 113 of the Tax Administration Act 1994.

The CIR has issued *Standard Practice Statement 16/01: Requests to amend assessments*[2] (SPS 16/01). SPS 16/01 sets out the process that the CIR will use to consider s 113 requests[3]. This statement sets out the s 113 process for considering whether the circumstances are appropriate for the CIR to agree to retrospectively alter an amount of shareholder's salary, irrespective of whether this alteration increases or decreases the amount of shareholder's salary.

Unless specified otherwise, all legislative references in this SPS are to the Tax Administration Act 1994 (the TAA).

Application

This SPS applies from 1 April 2018 and replaces *Standard Practice Statement 05/05: Retrospective adjustments to salaries paid to shareholder-employees*. This statement should be read with *Standard Practice Statement 16/01: Requests to amend assessments and Standard Practice Statement 09/02: Voluntary disclosures* (or any subsequent statements issued in replacement).

Standard practice

Process used to consider section 113 requests

1. The CIR acknowledges that in a self-assessment system taxpayers will occasionally take an incorrect tax position and that correcting these positions is an integral part of tax administration. Section 113 contains a broad discretion allowing the CIR to amend assessments to ensure their correctness.

2. As stated in *Westpac Securities NZ Ltd v Commissioner of Inland Revenue*[4] (at [65]):

   > …the focus of the inquiry as to whether the power was available would be centred on whether the amendment the taxpayer seeks to have made will ensure the assessment is correct when amended, even if it was also correct beforehand.

   The CIR's policy is generally to use the discretion to amend assessments that are requested where the amendment will lead to the issuing of a correct assessment.

3. In undertaking this approach, the CIR breaks the exercise into phases. SPS 16/01, from [34], describes these phases in the following terms:

   Phase one: An initial examination of the request. If it is clear and obvious that an error has occurred and that the error can be easily corrected, then the amendment will be made, subject to the application of phase four; the request will not have to progress through

[1] Search Keywords: SPS 18/01

[2] Published in *Tax Information Bulletin* Vol 28, No 4 (May 2016) at page 12 and on Inland Revenue's website **www.ird.govt.nz** (search keywords: SPS 16/01)

[3] From [32].

[4] [2014] NZHC 3377, (2014) 26 NZTC 21-118

STANDARD PRACTICE STATEMENTS

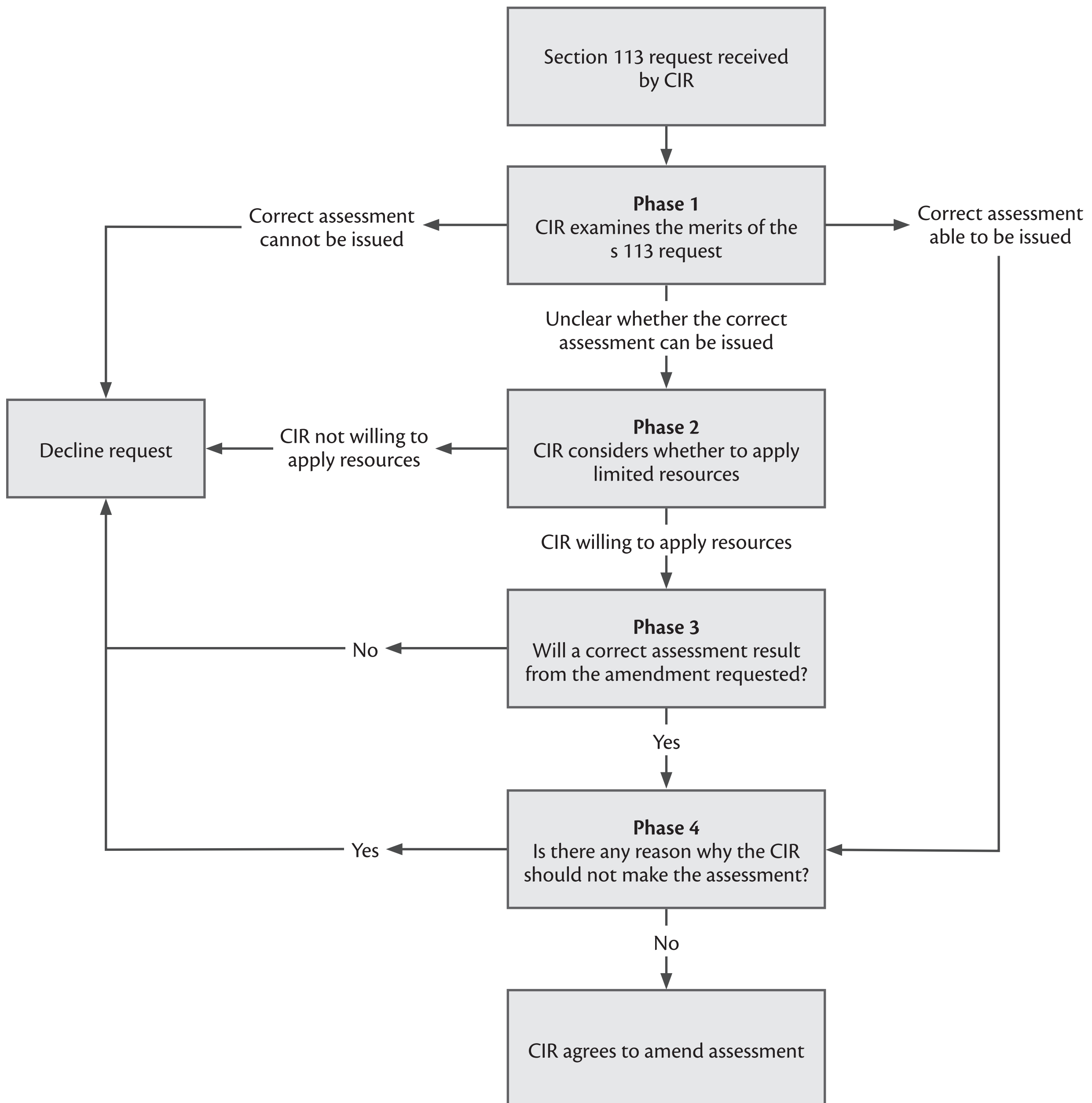
stages two and three. Conversely, if it is clear and obvious that agreeing to the request will not result in a correct assessment, the request will be declined at this phase.

Phase two: If it is unclear whether agreeing to the request will result in a correct assessment being issued, the Commissioner will need to consider whether further limited resources should be applied to consider the request further.

Phase three: In cases where it is decided to apply further resources the Commissioner will consider whether a correct assessment will result from the requested amendment.

Phase four: Determine whether there is any residual reason (other than her limited resources) why the Commissioner should not make the requested amendment.

4. The following flowchart illustrates the progress of a s 113 request through the 4 phases:



Correct assessment able to be issued

5. The setting of the amount of a shareholder's salary is generally a matter of contract between a company and its shareholder(s). The contractual nature of a salary means that the inclusion of any amount of salary in the company's and shareholders respective income tax returns will allow the CIR to issue a correct assessment.

6. Where the amount of a shareholder's salary initially agreed between the parties is found to be in error, the CIR's recognition of any mutually agreed changes to correct that error will also allow the CIR to issue a correct assessment.

7. As a correct assessment can always be issued by the CIR, changes in a shareholder's salary are an example of a s 113 request that can be progressed from phase 1 directly to phase 4 (see arrow on right of above flowchart).

Timing and matching principles

8. Sections EA 4 and EI 9 of the Income Tax Act 2007 ("the ITA") set out the timing and matching principles relevant to the tax consequences of shareholders' salaries. Put simply, an amount of a shareholder's salary is assessable to the shareholder in the same income year as deductibility is available to the paying company. Assessability is determined by whether, and when, an amount of salary is deductible.
9. An amount of salary does not have to have been physically paid before deductibility occurs. It is sufficient that a company is definitively committed to the expenditure[5] even where the exact quantum of that expenditure is yet to be determined.
10. Section EA 4(3) of the ITA states that the time for paying an amount of shareholder's salary is:

    …the last day by which the person could file a return of income for the income year if the time for filing were extended to its maximum under section 37(5) of the Tax Administration Act 1994.

11. The fact that there is a legislative timeframe for the payment of an amount of shareholder's salary does not affect the CIR's ability to correct the quantum of any shareholder's salary where an error has occurred in calculating the amount of that shareholder's salary (see further at [20]–[22] below).

Considering phase four requests

12. In discussing phase 4, SPS 16/01[6] states that where a request reaches this stage (because the CIR is satisfied that the amendment requested will lead to the making of a correct assessment) the assessment will be made unless making the assessment would undermine the integrity of the tax system. SPS 16/01 states (from [59]) that:

    59. These circumstances can include, for example:

    (a) Where the request is, or is part of, a tax avoidance arrangement.

    This is because, while the requested adjustment may be a correct interpretation of the law when considered in isolation, the Commissioner would not be convinced that the resulting assessment would be correct given the presence of tax avoidance. The Commissioner's view of the law on tax avoidance is set out in Interpretation Statement *IS 13/01 – Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007*[7]

    (b) Where a taxpayer requests the Commissioner to amend an assessment from one correct tax position to another position that is also correct

    When a taxpayer requests the Commissioner to amend an assessment from one correct tax position to another tax position that is also correct, the fact the original position was correct is a factor the Commissioner may take into account in deciding whether to use her discretion to make the amendment requested. As stated by Clifford J in *Westpac* at [67]:

    > There could be any number of valid reasons why the Commissioner may decline to exercise her discretion in situations of regretted correct tax positions including where the taxpayer appears to be gaming the system. ... The fact that Westpac, a well resourced, sophisticated and well advised taxpayer says that it "erred" when the relevant offset elections were made may be a proposition that the Commissioner will need to consider carefully when deciding whether or not to exercise her discretion.

    Two matters flow from these judicial comments. Firstly, whether a taxpayer erred in taking their original tax position is a factor the Commissioner may take into account in deciding whether to make the requested adjustment. A taxpayer could be said to have "erred" where they did not take the tax position they intended, through mistake or oversight, or the tax position they took, though technically possible and therefore already correct, was not one they would have taken if they had been in possession of all the relevant facts at that time.

    If the request arises from such an oversight, it is more likely the amendment will be made than if the request is simply the result of the taxpayer changing their mind. This is because the TAA places an obligation on taxpayers to make self-assessments correctly and it is not contemplated that unlimited additional variations can be made at a cost to the Commissioner. Amendments should not be able to be made merely at will. On this basis, a request for multiple changes to tax positions will also be unlikely to be agreed to.

    The Commissioner may also take into account the fact a taxpayer is "well resourced, sophisticated and well advised", and therefore generally better equipped to be able to evidence the fact that they erred in taking their original position.

    60. To allow an amendment in these circumstances may have a negative impact on other taxpayers' perceptions of the integrity of the tax system, especially as they relate to the concepts of statutory timeframes[8], certainty and their own future voluntary compliance. In these instances, the decision to not apply the discretion will be made by a senior Inland Revenue officer, with advice from the Legal and Technical Services group.

[5] *King v C of IR* (1973) 1 NZTC 61,107; [1974] 2 NZLR 190; *CIR v Glen Eden Metal Spinners Ltd* (1990) 12 NZTC 7,270.

[6] At [59]

[7] More information on this statement may be found on Inland Revenue's website **www.ird.govt.nz** (search keywords: IS 13/01)

[8] *CIR v Wilson* (1996) 17 NZTC 12,512; *Charter Holdings Ltd v CIR* [2015] NZHC 2041

Part of a tax avoidance arrangement

13. If the CIR considers that declaring a new amount of salary was part of a wider tax avoidance arrangement, or is the arrangement, the requested adjustment will not be made for the reasons stated at [12][9] above.

Changing from one correct tax position to another correct tax position

14. A s 113 request will progress through phase 4, and the requested salary adjustment will be made, if a taxpayer is able to demonstrate to the CIR's satisfaction that they "erred" in taking their original tax position. That is, the quantum of salary initially declared was declared in error.

15. As stated at [12][10] above, it is the CIR's view that a taxpayer can be said to have "erred" *where they did not take the tax position they intended, through mistake or oversight, or the tax position they took, though technically possible and therefore already correct, was not one they would have taken if they had been in possession of all the relevant facts at that time*[11].

16. A taxpayer will need to provide the CIR with evidence that the initial salary was declared in error. It will not be enough to show that some other tax position in their tax return is in error and that, as a result of that error, they now wish to alter the amount of shareholder's salary.

17. For example, in *Case U27*[12] a company's accountant relied on incorrect information supplied to him by the company's majority shareholder. As a result of this misinformation, the company's profit was overstated. The company had a policy of declaring salaries at no more than the company's profit in any year. As a result of the overstatement of the company's profit, the amount of shareholders' salaries was also overstated. The CIR agreed to use the s 113 discretion to correct the errors made in the company's income tax return, but did not agree to amend the shareholder's salary.

18. In finding for the taxpayer, the Taxation Review Authority held that the company was not irretrievably bound by the amount of shareholder's salary that had been declared in error. To find otherwise would, in the words of the Authority, be so patently unjust that a Court would only come to such a conclusion if inescapably driven to do so by binding authority or the clearest parliamentary intention. In the Court's view, no such authority or intention existed.

19. In *Case U27* the taxpayers were able to show that they had erred in **both** the tax positions taken to arrive at the company profit **and** the amount of shareholder's salary initially declared. In this circumstance it would be appropriate for the CIR to apply the s 113 discretion to correct both errors made by the taxpayer. If the Court had found that there had been no error in declaring the amount of shareholder's salary, the CIR would not have been bound to use the s 113 discretion[13]. See also [24] below.

How errors will be corrected

20. In correcting errors made in tax returns, s 113 contains a broad discretion allowing the CIR to amend assessments to ensure their correctness.

21. Declaring an amount of shareholder's salary is generally a matter of contract between a company and its shareholder. Where a shareholder and company agree that an error has occurred in quantifying the amount of salary to be declared for a year, that error can be corrected without the original contract being voided and a new contract entered into. As long as the declaration of the original salary (the salary declared in error) met the requirements of the timing and matching principles contained in ss EA 4 and EI 9 of the ITA, these sections will not impact on the ability of the CIR to correct the error.

22. Where the shareholder and company are able to provide evidence to the CIR's satisfaction that an error has been made in the quantum of shareholder's salary originally declared, the CIR will correct that error. For the above reasons it is not relevant whether the new salary is greater or less than the original salary that was declared.

All parties must agree

23. As the amount of shareholder salary is a matter of contract between a shareholder and a company, the CIR will not consider using the s 113 discretion to amend assessments unless both parties to that contract agree that an error has been made. Until agreement is reached, it is the CIR's view that any dispute between the shareholder and the company is a civil matter that is properly addressed, if necessary, through the Courts[14].

[9] At 59(a)

[10] At 59(b)

[11] See SPS 16/01 at [59(b)] and [12] above

[12] (1999) 19 NZTC 9,261

[13] See for instance, *Case Q49* (1993) 15 NZTC 5,254.

[14] See for instance, *Spence v Commissioners of Inland Revenue* 24 TC 311

Amending shareholder's salary where no error has occurred

24. Where taxpayers request that the shareholder's salary be amended and they are unable to provide evidence that the original salary was declared in error, any amendment to that original salary can only have prospective effect. This is made clear by Willey DCJ in *Case U27*, in which he discussed the outcome of *Case Q49* and stated, "it was simply that the company and the shareholders later repented of their bargain and sought to reverse it. No questions of restitution or rectification arose and therefore any new arrangement which they were free to enter into could only have prospective effect". See also comments made in SPS 16/01 (at [59(b)]) and at [12] above.

Examples of when the Commissioner generally will agree to adjust an amount of shareholder's salary

When the amount of company profit is shown to be in error:

25. Where:
    - the CIR has agreed to use the s 113 discretion to correct an error in a company's accounts, or
    - the taxpayer otherwise agrees that the CIR is able to correct an error in the company accounts (by signing an agreed adjustment, for instance),

    the process set out in SPS 16/01 will be followed. That is, the CIR will agree to adjust an amount of shareholder's salary previously declared, where the taxpayer can also evidence the fact that, due to the error in the company's accounts, this amount of salary is now also in error. This could occur, for instance, in the following situations:
    - The company's profit has been amended and the company and shareholder have historically agreed that all company profit will be declared as salary to the shareholder (and this agreement has not changed).
    - The company's profit has been amended and the company and shareholder have historically agreed that a fixed percentage of company profit will be declared as salary to the shareholder (and this agreement has not changed).
    - The company and shareholder have historically agreed that salary will only be declared out of company profits and not losses (and this agreement has not changed). Where an amendment to the company accounts sends the company from a profit to a loss situation (or vice versa), then the appropriate salary adjustment may be made.
    - The company and shareholder are otherwise able to evidence that, had they been aware of the correct level of company profit, they would have declared an amount of salary that differs from that originally declared. For instance, the taxpayers may be able to successfully argue that altering the level of shareholder's salary would be, from an accounting perspective, the most logical treatment of the salary in the circumstances.

When the amount of company profit is not in error:

26. The CIR may agree to exercise her s 113 discretion where the company and shareholder are able to provide evidence that the amount of shareholder's salary shown in the company accounts (and returned as income by the shareholder) was not the amount that had been agreed at the time the salary was declared. That is, the amount of salary shown in the returns of income is factually incorrect. For example, the amount of shareholder's salary may have been the subject of arithmetic, transposition or keying error.

Examples of when the Commissioner will generally not agree to adjust an amount of shareholder's salary

When the amount of adjusted salary is or is part of a tax avoidance arrangement:

27. No adjustment will be made. See further at [12] and [13] above.

When the taxpayer is unable to provide evidence that the original salary declared was declared in error:

28. No adjustment will be made.
29. As no error has occurred any adjustment can only be prospective from the date that a change in salary occurred. For example, rather than an error having occurred, the request may arise out of an intention to adjust the shareholder's salary to alter the shareholder's child support liability, to increase the shareholder's entitlement to family assistance, or to assist with the company's cash flow. See also SPS 16/01 (at [59(b)]), and [12] and [24] above.

Not all of the parties to the contract agree that an error has occurred:

30. No adjustment will be made.
31. As the amount of shareholder salary is a matter of contract between a shareholder and a company, the CIR will not consider using the s 113 discretion to amend assessments unless both parties to that contract agree that an error has been made. Until agreement is reached, it is the CIR's view that any dispute between the shareholder and the company is a civil matter that is properly addressed, if necessary, through the Courts. See also [23] above.

This Standard Practice Statement is signed on 30 January 2018.

Rob Wells
Manager, Technical Standards, OCTC

APPENDIX

Tax Administration Act 1994

Section 113 Commissioner may at any time amend assessments

(1) **[Amendment at any time]** Subject to sections 89N and 113D, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.

(2) **[Fresh liability]** If any such amendment has the effect of imposing any fresh liability or increasing any existing liability, notice of it shall be given by the Commissioner to the taxpayer affected.

Income Tax Act 2007

Section BD 3 Allocation of income to particular income years

...

Income credited in account

(4) Despite subsection (3), income that has not previously been derived by a person is treated as being derived when it is credited in their account or, in some other way, dealt with in their interest or on their behalf.

Section EA 4 Deferred payment of employment income

...

Extension of payment period for shareholder-employee

(3) For employment income paid to a shareholder-employee, the 63 day period for payment in subsection (1)(b)(i) is extended until the last day by which the person could file a return of income for the income year if the time for filing were extended to its maximum under section 37(5) of the Tax Administration Act 1994.

Section EI 9 Matching rule for employment income of shareholder-employee

Matching if company allowed deduction

(1) If a company is allowed a deduction for expenditure on employment income that is paid or payable to a shareholder-employee under section CE 1 (Amounts derived in connection with employment), the income is allocated in the way set out in subsections (2) and (3).

Allocation to deduction year unless unexpired

(2) The income is allocated to the income year to which the deduction allowed to the company is allocated, except for an amount equal to any unexpired portion for the income year of the company's expenditure under section EA 4 (Deferred payment of employment income).

Allocation when no longer treated as unexpired

(3) The remaining income is allocated to the income year or years in which the corresponding amount of the company's expenditure on the income is no longer treated as an unexpired portion.

LEGISLATION AND DETERMINATIONS

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

Livestock values - 2018 national standard costs for specified livestock

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2017-2018 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard cost ("NSC") scheme to value any class of specified livestock.

Farmers using the scheme apply the rising one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding and rearing rising one-year and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overheads, costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2017 is used while other dairy NSCs are based on the 2016-2017 income and expenditure from a DairyBase sample of owner-operated dairy farms. For sheep, beef cattle, deer and goats, NSCs are based on survey data from the 2015-2016 sheep and beef farm survey conducted by the Beef & Lamb New Zealand Economic Service. This is the most recent information available for those livestock types at the time the NSCs are calculated in December 2017.

For the 2017-2018 income year there has been a small increase in the NSCs for all livestock types except deer, bobby calves and dairy goats. The main contributor to the small decrease in the NSC for deer was a decrease in expenditure on fertilizer.

There has been a substantial increase in NSCs for both bobby calves and dairy goats. In respect of bobby calves, this increase comes after a period of very low costs (attributed to a response to low farm-gate milk prices). In the current year there has been a 38% increase in feedstuffs and a 27% increase in freight costs, together with smaller increases in the costs associated with animal health and labour.

The increased NSCs for both rising one-year and rising two-year dairy goats have come about because of a change in the calculation methodology. In recent years the dairy goat farming industry has changed from a largely pasture based model to a primarily housed farming system. As a result of these changes, the NSC formula has been updated to take account of the different costs structure attributable to this housed farming model. The resultant increase in costs is being phased in over the next three years.

The NSCs calculated each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self-assessed cost scheme ("SAC") option. SAC is calculated on the same basis as NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

National Standard Costs for Specified Livestock Determination 2018

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2018".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2017-2018 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007 the national standard costs for specified livestock for the 2017-2018 income year are as set out in the following table.

Kind of livestock	Category of livestock	National standard cost $
Sheep	Rising 1 year	34.60
	Rising 2 year	24.10
Dairy Cattle	Purchased bobby calves	186.00
	Rising 1 year	437.30
	Rising 2 year	333.30
Beef Cattle	Rising 1 year	362.50
	Rising 2 year	203.40
	Rising 3 year male non-breeding cattle (all breeds)	203.40
Deer	Rising 1 year	95.30
	Rising 2 year	49.30
Goats (Meat and Fibre)	Rising 1 year	28.30
	Rising 2 year	19.40
Goats (Dairy)	Rising 1 year	184.50
	Rising 2 year	40.50
Pigs	Weaners to 10 weeks of age	103.90
	Growing pigs 10 to 17 weeks of age	86.20

This determination is signed by me on the 1st day of February 2018.

Rob Wells
Manager, Technical Standards, OCTC

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.

Application for Interim Liquidator

Case	The Commissioner of Inland Revenue v Chesterfields Preschools Limited & Therese Anne Sisson [2017] NZHC 3172
Decision date	15 December 2017
Act(s)	s 246 Companies Act 1993
Keywords	"Interim liquidator"

Summary

Associate Judge Matthews was satisfied that the interests of creditors would be safeguarded by interim liquidators being appointed, as the assets are in jeopardy.

Impact

The order prevents the company from dealing with the property pending the outcome of the High Court liquidation rehearing.

Facts

This follows the judgment of the Supreme Court dated 23 November 2017 which set aside the order made by the High Court in 2015 putting the company into liquidation and ordering a rehearing of the High Court liquidation.

Chesterfields Preschools Limited ("Chesterfields") has two assets, a property at 854 Colombo Street, Christchurch and an insurance policy over a building which was previously on the land at 854 Colombo Street, Christchurch.

The Commissioner of Inland Revenue ("the Commissioner") is the principal creditor of Chesterfields. Income tax and goods and services tax ("GST") arrears amount to $1,088,461.15 (This figure was established as at 22 July 2008 after application of a 15 per cent penalty relief, as suggested by the Court of Appeal, and an allowance for the cancellation of some interest.). The total amount currently owing, including income tax, GST, and court costs is $1,120,566.15. The Commissioner also claims a further $570,958.92 in GST from the sale of a neighbouring property and insurance proceeds.

Decision

The application was served on all three persons named as directors of Chesterfields. However, two of them, Ms Sisson and Mr Hampton are undischarged bankrupts and are therefore disqualified from holding office as directors by s 151(2)(b) of the Companies Act 1993.

Therefore, Chesterfields had only one director, Anna Hampton, who did not take steps to oppose the application. Ms Sisson had filed an opposition to the Commissioner's application; however, it was disregarded as she could not represent the company.

Associate Judge Matthews referred to the three factors to be considered in relation to an application under s 246 of the Companies Act 1993 identified in *Robert Bryce & Co Ltd v Chicken & Food Distributors Ltd* (HC Wellington M297/90, 13 August 1990) namely:

(a) Whether the company's assets are in jeopardy;

(b) Whether the status quo should be maintained;

(c) Whether the interest of creditors are safeguarded

Ms Sisson assessed the land value at $875,000 and had been trying to negotiate the sale of the land with neighbours of the property without the consent of the liquidator. However, no registered valuation was before the court nor were the terms on which the property might be sold. These facts established prima facie that the asset was in jeopardy.

Ms Sisson had also been negotiating a mortgage over a title to the property in order to secure $109,000; this being the sum the Court of Appeal required to be paid as a condition for the termination of the liquidation. These actions also raised the prospect that the property may be in jeopardy.

While the property had a caveat on the title, this would not stop Chesterfields entering into contractual arrangements with other parties.

The evidence before the Court also supported the view that Chesterfields was insolvent. To ensure a maximum return to creditors, it was imperative the remaining assets were handled responsibly.

As the assets were in jeopardy, the Court was satisfied it was in the interests of creditors for an interim liquidator to be appointed.

Notices issued under s 17 of the Tax Administration Act 1994 held to be invalid

Case	Chatfield & Co Ltd v Commissioner of Inland Revenue [2017] NZHC 3289
Decision date	22 December 2017
Act(s)	Tax Administration Act 1994: s 17, Judicature Amendment Act 1972, Double Taxation Relief (Republic of Korea) Order 1983 (SR 1983/5): Schedule 1
Keywords	Judicial review – Justiciability – Relevant Considerations - Double tax agreement

Summary

Chatfield & Co Ltd and Chatfield & Co ("collectively **Chatfield**") applied to judicially review a decision of the Commissioner of Inland Revenue ("the Commissioner") to issue 15 Notices to Furnish Information under s 17 of the Tax Administration Act 1994 ("the TAA") to it ("the Notices"). A partially successful strike out application left one cause of action (being an alleged failure to take into account the terms of a double taxation agreement between the Republic of Korea ("Korea") and New Zealand ("NZ") ("the DTA")) to proceed to a substantive hearing. The High Court found that cause of action was made out and granted the application for judicial review, quashing the Notices.

Any appeal of the judgment must be brought by 13 February 2018.

Impact

The judgment provides guidance on the interpretation of Article 25 of the NZ-Korea DTA.

Facts

The National Tax Service of the Republic of Korea ("the NTS") asked the Commissioner, pursuant to the DTA, to obtain and provide certain information relating to a number of Companies ("the Companies") associated with a Korean Taxpayer ("the Taxpayer").

Information relating to five of the Companies was able to be obtained from the Commissioner's existing records or publicly available sources. The remaining material was not available through these sources. The Commissioner accordingly proceeded to issue the Notices to Chatfield, the tax agent for the Companies, under s 17 of the TAA, in relation to that remaining material, referencing article 25 of the DTA. The Notices were signed by an Investigations Team Leader.

In May 2015 Chatfield commenced judicial review proceedings challenging the Commissioner's decision to issue the Notices. They also sought orders for the disclosure of the NTS request and any and all exchanges between the Commissioner and the NTS relating to it.

That application for disclosure was declined. While Ellis J agreed that in principle it was possible to obtain such disclosure, and disclosure is governed by s 81 of the TAA, her Honour ultimately formed the view that the Commissioner was not required to disclose the requested documents pursuant to s 81. This was upheld by the Court of Appeal (on the basis the documents were not relevant to Chatfield's amended claim) and leave to appeal to the Supreme Court was declined.

Decision

The Court granted the application for judicial review, declaring that the decision to issue the Notices was invalid and quashing the Notices.

Section 17 of the TAA, DTAs and Exchange of Information

The Court accepted s 17 powers may be used for the purposes of gathering information for exchange with a foreign state under the DTA as it forms part of the Revenue Acts.

The Court noted that in an increasingly globalised environment where not all information required to monitor compliance with a taxpayer's obligations will be available in any one state tax treaties seek to facilitate exchange of information between states.

The Court noted the unique nature of DTAs which have direct effect in NZ's domestic law once given effect by order in council, and that in the event of any inconsistency with the Revenue Acts s BH 1 of the Income Tax Act 2007 provides the DTA prevails.

Justiciability

The Court rejected the argument that the decision to issue the Notices was not justiciable, finding that:

1. the case did not question the executive's decision to enter into the DTA, raise comity issues, nor challenge any act of Korea as a foreign state;
2. the DTA forms part of NZ domestic law and interpretation of both the TAA and DTA is within the Court's constitutional competence;
3. the case did not concern high policy or politically fraught issues;
4. the Commissioner's actions in issuing s 17 notices can be the subject of judicial review if the Commissioner exceeds or abuses her powers (and prior authority in the DTA context is to the same effect); and
5. other checks and balances applicable to DTAs (in particular the OECD's peer review regime) do not involve curial oversight, focus on individual cases or provide remedies to individual taxpayers.

Lawfulness of actions

The parties accepted that faced with the request for the exchange of information from the NTS Mr Nash must be satisfied:

1. the information sought came within the terms of the DTA and NZ's tax laws;
2. the nature of the information sought was (or at the least appeared to be) consistent with the grounds for the request; and
3. the type of information sought was broadly what would be expected to be necessary for or relevant to any inquiry of the nature indicated.

The Court determined that the word "necessary" in art 25 of the DTA required the competent authority to satisfy himself by clear and specific evidence that all of the information requested was needed or required in relation to an investigation into, or other action being taken by the NTS against a Korean taxpayer and the information was in relation to income tax, corporation tax, inhabitant tax or fiscal evasion. He also had to be satisfied any information exchanged would only be used in relation to those taxes and that the NTS had been unable to obtain the information in Korea.

The Court did not agree it could simply consider the Commissioner's affidavits (and ask whether there are any errors of a material or substantive nature evident from them), nor rely on Mr Nash's assurances and infer he had considered all that he was required to.

The Court noted the difficulty caused by the absence of the NTS request letter, any correspondence between Mr Nash and the NTS in relation to the request or file notes from Mr Nash in relation to the matter (the material), (noting Chatfield's unsuccessful attempts to obtain the material through the Courts) and did not consider an offer to make relevant material available on a confidential basis to be acceptable on the basis that it would be contrary to the rules of natural justice.

The Court had asked the Commissioner to seek NTS views on the release of the material to an amicus curiae to enable the Court to hear opposing argument on the issue. The response was opposition to both the proposed release of the documents to an amicus and the provision of the letter outlining that opposition to anyone other than the Court.

The Court was not satisfied with the information supplied by the Commissioner and found it could not be satisfied that the nature of the information sought by NTS was consistent with the grounds for the request and that the information was of a sort which would broadly be expected to be necessary or relevant to any inquiry of the nature indicated in the request.

The Court noted that while a judicial review applicant bears the burden of proof on the balance of probabilities, the evidential burden will be relatively low where the facts are within the knowledge of the other party, particularly where the Court has to determine whether the relevant facts on which the exercise of the power in issue turns, did or did not exist.

The Court found this to be such a case. Based on the little raised by Chatfield and the limited evidence filed on behalf of the Commissioner, the Court was not satisfied Mr Nash had undertaken the appropriate inquiries.

Delegation

The Court considered the argument the Investigations Team Leader who signed the Notices was not a competent authority and had no authority to make any decisions under article 25 of the DTA to be misconceived as nothing in the DTA or TAA requires Mr Nash to personally take the necessary administrative steps to procure information.

Intensity of Review

The Commissioner submitted the Court should only intervene if it found the nature of the information sought was such that it could not be potentially necessary to an investigation relating to one or more of the taxes set out in article 2 of the DTA. She also submitted neither the Court nor Mr Nash could be expected to inquire into factual assertions underlying the request nor what is required under Korean law as to do so would amount to a mini trial involving the determination of potentially difficult questions of foreign law.

The Court found there was no need for deference to the Commissioner when inquiring into TAA or DTA requirements and that review in this context can and should be hard-edged, applying a "correctness standard". The question is whether or not the Court can be satisfied Mr Nash did what he was required to do by law and there was nothing in the facts to support a conclusion that a light touch, deferential or lesser standard of review was required or appropriate.

When does the response period to issue a NOR start following the Taxation Review Authority's decision that a NOPA should have been accepted out of time?

Case	TRA 005/17 [2018] NZTRA 01
Decision date	29 January 2018
Act(s)	Goods and Services Tax Act 1985, Tax Administration Act 1994 ss 89AB, 89AC, 89H(2), 89K
Keywords	Deemed acceptance

Summary

TThe Taxation Review Authority ("TRA") concluded that s 89AC of the Tax Administration Act 1994 ("TAA") applied to this dispute and that the Commissioner of Inland Revenue's ("the Commissioner") Notice of Response ("NOR") was issued within the requisite response period. Even if s 89AC was not applicable, the Commissioner's NOR was issued within the response period under s 89AB (prior to amendment). Furthermore, even if it was not, there has been no deemed acceptance of the disputant's Notice of Proposed Adjustment ("NOPA") by the Commissioner under s 89H(2).

Impact

Section 89AC specifies that when an initiating notice (such as a NOPA or statement of position) is filed late, the response period starts from the date of the decision of the Commissioner or the Court to accept the initiating notice out of time. This decision confirms that s 89AC applies to decisions made by the Commissioner or the Court since 24 February 2016, when the section came into force.

Similarly, the decision also confirmed that prior to the introduction of s 89AC, the wording of ss 89K(1) and 89AB(2) was not to be taken as meaning that the response period ran from the date the late NOPA was issued, but rather from the date of the decision to accept the initiating notice out of time.

Finally, the decision followed previous case law that there can be no deemed acceptance in these circumstances, as the NOPA is not valid until exceptional circumstances are found by either the Commissioner or the Court. As such, the ordinary dispute procedures in Part 4A of the TAA, such as deemed acceptance, are not applicable.

Facts

The Commissioner issued a Notice of Assessment for the GST period ended 31 October 2008 on 16 April 2013. Almost two years later, the disputant issued a NOPA dated 30 March 2015 which included a request under s 89K to have the NOPA treated as if it had been given within the applicable response period.

By letter dated 29 April 2015, the Commissioner refused to accept the NOPA under s 89K. On 9 July 2015 the Commissioner was served with proceedings in the TRA challenging, among other things, the Commissioner's refusal to accept the NOPA.

On 5 May 2016 the TRA issued its decision (*Case 4/2016* [2016] NZTRA 0427, (2016) NZTC 3/026). In relation to s 89K, the TRA concluded that the Commissioner's decision to refuse to accept the NOPA out of time was incorrect, and it was set aside accordingly.

On 28 June 2016 the Commissioner issued her NOR. The disputant and the Commissioner then issued statements of position and a challenge notice was given by the Commissioner on 31 May 2017.

On 19 July 2017 the disputant filed this claim in the TRA.

Decision

Does s 89AC apply?

The TRA found that the meaning and purpose of s 89AC is clear and that is, to specify a response period for the filing of a NOR by the Commissioner where the provisions of s 89K are met by a disputant. The provision is purely of a procedural nature. It came into force on 24 February 2016, and was not restricted in its application to disputes commenced after that date.

The TRA was satisfied that ss 89AB(2) and 89AC apply to this dispute and found that the Commissioner's NOR was issued within the requite response period set out in s 89AC(2) and is valid.

Situation in the event that s 89AC does not apply?

The TRA also considered whether there would have been deemed acceptance under the prior s 89AB. The TRA found that until exceptional circumstances are established, a late NOPA does not have any effect and in these circumstances, it follows that there is no obligation on the Commissioner to issue a NOR at that time.

Section 89K(1) of the TAA says that where exceptional circumstances are subsequently found, then the disputant's NOPA is to be "treated for all purposes under this Part as if it had been given within the applicable response period". The TRA noted that s 89K(1) does not refer to the response document and concluded that there was no basis on which to conclude that the 2-month response period to file the NOR commences from that date that a disputant issued its late NOPA. Her Honour Judge Sinclair noted that in most cases, this period would have expired before any decision would likely be made by a hearing authority in the event of a challenge to the Commissioner's refusal to find exceptional circumstances.

Finally, the TRA stated that even if it could be argued that an earlier response period applied, it did not accept there had been deemed acceptance of the disputant's NOPA by the Commissioner. Her Honour followed the reasoning of Heath J in *Jacobs-Maxwell v Commissioner of Inland Revenue* (2011) NZTC 20,094 that no question of deemed acceptance arises if the ordinary disputes resolution procedures set out in Part 4A are not applicable. As the disputant had failed to issue a valid NOPA within the requisite time period and had to establish exceptional circumstance under s 89K, the claim clearly fell outside those ordinary procedures.

Part of claim that did not comply with strict procedural requirements struck out by Taxation Review Authority

Case	TRA 008/17 [2018] NZTRA 02
Decision date	29 January 2018
Act(s)	Tax Administration Act 1994, ss 89C(eb), 138B & 138H
Keywords	Strike-out

Summary

The Taxation Review Authority ("TRA") upheld an application by the Commissioner of Inland Revenue ("the Commissioner") to strike out those parts of the disputant's Notice of Claim that related to the Commissioner's 2011 reassessment of a GST return filed by the disputant in 2008.

Impact

This decision confirms that the procedural requirements for commencing challenge proceedings are strictly adhered to. Where a challenge has been filed that does not meet those requirements, it is not possible to "piggy back" the claim onto a challenge which has been correctly brought, as the non-compliant parts of the challenge will be struck out pursuant to s 138H.

Facts

On 30 May 2011 the Commissioner issued a notice of (re)assessment to the disputant for the GST period ended 31 July 2008 amending the GST refund of $144,706.72 claimed by the disputant to nil (2008 Reassessment). This reassessment was made pursuant to s 89C(eb) of the Tax Administration Act 1994 ("TAA").

A Notice of Proposed Adjustment ("NOPA") was received by the Commissioner on 29 July 2011.

On 3 August 2011 a Notice of Claim was filed by the disputant in the TRA and served on the Commissioner.

The Commissioner sent a letter dated 25 August 2011 to the disputant stating that the Commissioner would be rejecting the NOPA in full. The Commissioner's Notice of Response ("NOR") was issued on 26 September 2011.

On 3 November 2011 the Commissioner received a letter from the disputant rejecting the NOR.

On 24 November 2011 the Commissioner asked the disputant to confirm whether he intend to continue the challenge proceeding already commenced in the TRA or to pursue the disputes process with the Commissioner. The disputant replied stating that he intends to pursue the challenge proceedings and request that the disputes process "be put in abeyance in the meantime".

A Notice of Discontinuance of the TRA proceeding was filed by the disputant on 30 September 2013. On the same date, he wrote requesting that the Commissioner progress the dispute. The Commissioner replied stating that by discontinuing the TRA proceeding, the disputant had accepted the Commissioner's assessment. Further, she stated that the challenge had been finalised and there was no longer any dispute to progress.

On 3 August 2015 the disputant wrote to the Commissioner noting that it was more than 4 years since the disputant's NOPA was issued and requesting that the refund be paid. On 19 September 2016 the Commissioner sent a letter to the disputant stating that no GST refund would be paid.

In 2017 the disputant issued challenge proceedings in the TRA in respect of two disputable decisions: (1) the cancellation of the disputant's GST registration; and (2) the 2008 Reassessment. The Commissioner applied to strike out those parts of the 2017 Notice of Claim that related to the 2008 Reassessment on the basis of lack of jurisdiction or, alternatively, abuse of process.

Decision

The judgment briefly set out the principles applying to strike out applications – that a cause of action may only be struck out where it is so clearly untenable that it cannot possibly succeed, and that the jurisdiction is to be exercised sparingly and only in clear cases.

The disputant submitted that s 138B(1) was the applicable subsection and the Commissioner submitted that s 138B(3) applied. Section 138B(1)(a) allows the disputant to challenge an assessment by commencing proceedings in a hearing authority if the assessment includes "an adjustment proposed by the Commissioner" which the disputant has rejected within the applicable response period.

The Judge referred to *Allen v Commissioner of Inland Revenue* [2006] NZLR 1, where the Court of Appeal considered the term "adjustment proposed" in s 138B(3). The Court stated that the term "adjustment proposed" in s 138B(3) refers to an adjustment proposed in a NOPA. The TRA in the present case noted that the words "adjustment proposed" are also used in s 138B(1) and (2) and it has been accepted that the same meaning applies in each of these subsections.

The Commissioner issued the 2008 Reassessment pursuant to s 89C(eb). Under this subsection, the Commissioner can make an assessment without first issuing a NOPA where she has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity. Judge Sinclair confirmed that where the Commissioner issues an assessment without first issuing a NOPA, and the disputant wishes to contest that assessment, then the disputant is required to issue a NOPA and s 138B(3) applies.

Where pursuant to s 138B(3)(a), the Commissioner issues a NOR within the applicable response period rejecting the adjustment proposed by the disputant and does not subsequently issue an amended assessment, the disputant is entitled under s 138B(3)(b) to challenge that assessment by commencing proceedings in a hearing authority within the "response period of the written disputable decision by the Commissioner that the proposed adjustment will not be adjusted".

The TRA stated that the claim relating to the 2008 Reassessment included in the Notice of Claim filed in 2017 had not been filed within any applicable response period (which would have commenced in 2011). Furthermore, it is not possible to overcome the difficulties in this situation by endeavouring to "piggy back" the claim on a challenge which has been correctly brought. No application was made for extraordinary circumstances.

The TRA stated that the disputant breached the strict procedure for the commencement of a challenge proceeding and the TRA has no discretion and no jurisdiction to consider the claim. The cause of action relating to the 2008 Reassessment was accordingly struck out.

In light of her decision, the Judge did not consider the alternative argument of abuse of process.

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